No. 85-1493

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM 1985

METROPOLITAN EDISON COMPANY,
Appellant,

—against—

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee,

OFFICE OF CONSUMER ADVOCATE ET AL.,
Intervenors.

PENNSYLVANIA ELECTRIC COMPANY,
Appellant,

—against—

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee,

OFFICE OF CONSUMER ADVOCATE ET AL.,
Intervenors.

ON APPEAL FROM THE SUPREME COURT OF PENNSYLVANIA

JURISDICTIONAL STATEMENT

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Question Presented

Was the Court below correct in holding that the investor-interest components of the criteria for determining whether electric utility rates are "just and reasonable", as specified by this Court in *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591, 603 (1944) and its progeny, are not of "constitutional dimension"?

Parties to the Proceeding

In addition to Appellants and Appellee, the parties to the proceeding before the Supreme Court of Pennsylvania were the Office of Consumer Advocate, Abex Corporation, Airco, Inc., Avtex Fibers, Inc., P. H. Glatfelter Co., St. Regis Paper Company, Gypsum Company and the American Society of Utility Investors.

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ON APPEAL FROM THE SUPREME COURT OF PENNSYLVANIA

JURISDICTIONAL STATEMENT

Metropolitan Edison Company ("Met-Ed") and Pennsylvania Electric Company ("Penelec"), the Appellants,* appeal from the final judgment of the Supreme Court of Pennsylvania which held that the investor-interest components of the criteria for de-

*Met-Ed and Penelec (the "Companies") are subsidiaries of General Public Utilities Corporation. The Companies are affiliated with Jersey Central Power & Light Company, GPU Service Corporation, GPU Nuclear Corporation, Cherry Hill Fuels Corporation, Energy Initiatives, Inc. and Saxton Nuclear Experimental Corporation.

termining whether electric utility rates fixed by a rate regulatory agency are "just and reasonable", as specified by this Court in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) and its progeny,* are not of "constitutional dimension". On this basis, the Supreme Court of Pennsylvania held that the order of the Pennsylvania Public Utility Commission ("PUC"), the Appellee, fixing Appellants' rates for electric service at a level which does not meet those investor-interest criteria is not violative of the Constitution of the United States. Appellants submit this statement to show that the Supreme Court of the United States has jurisdiction of these appeals and that a Federal Constitutional question of substantial public importance is presented.

Opinions Below

The opinion of the Supreme Court of Pennsylvania is not yet reported. *Pennsylvania Electric Co.* v. *Pennsylvania Public Utility Commission*, Nos. 31 & 32 M.D. Appeal Docket 1984 (Pa. Dec. 9, 1985) (available Feb. 18, 1986, on LEXIS, States library, Pa. file) (A1).** The opinion of the Commonwealth Court of Pennsylvania is reported at 78 Pa. Commw. Ct. 402, 467 A.2d 1367 (1983) (A13). The order of the PUC, dated July 27, 1981, is not reported (A25).

Grounds for Jurisdiction

The instant appeals arise out of the proposed annual electric base rate increases of $76.5 million (Met-Ed) and $67.4 million (Penelec) which the Companies filed with the PUC on July 29, 1980. On July 27, 1981, the PUC entered a single

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**See, e.g., Permian Basin Area Rate Cases*, 390 U.S. 747, 770 (1968); *FPC* v. *Memphis Light, Gas & Water Div.*, 411 U.S. 458, 466 (1973).

***Citations to Appellants' Appendix annexed hereto are in the form "A ____".

final order with respect to these rate filings authorizing annual increases of $51.8 million (Met-Ed) and $55.4 million (Penelec). Upon the Companies' petitions for review, that order was affirmed by the Commonwealth Court of Pennsylvania. Thereafter, on December 9, 1985, the Supreme Court of Pennsylvania affirmed the order of the Commonwealth Court. Appellants' Notice of Appeal to the Supreme Court of Pennsylvania was filed on March 4, 1986 (A36).

Because the actions of the PUC are the equivalent of a statute of Pennsylvania for jurisdictional purposes, jurisdiction to review the order of the Supreme Court of Pennsylvania is conferred upon this Court by 28 U.S.C. § 1257(2). *Lathrop* v. *Donohue*, 367 U.S. 820 (1961); *Atchison, Topeka & Santa Fe Railway* v. *Public Utilities Commission*, 346 U.S. 346 (1953); *Live Oaks Water Users' Association* v. *Railroad Commission*, 269 U.S. 354 (1926); *Bluefield Water Works & Improvement Co.* v. *Public Service Commission*, 262 U.S. 679 (1923); *Lake Erie & Western Railroad* v. *Public Utilities Commission*, 249 U.S. 422 (1919); *Williams* v. *Bruffy*, 96 U.S. 176 (1878).

In the proceedings before the PUC, the Companies argued that, while the PUC has complete discretion to select whatever rate-making methodology or formula it chooses, the Fifth and Fourteenth Amendments mandate that the end result of its rate making orders must balance the interests of consumers and investors in the manner delineated by this Court in *Hope*, (1) "to protect consumers against exploitation" and (2) "to promote the 'financial integrity' of the natural gas companies as measured, not only by revenues sufficient to recover operating expenses and capital costs . . . but also by revenues 'sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.'"*

*This summary of the holding in *Hope* appears in the opinion of Justice Douglas (the author of the majority opinion in *Hope*) speaking for a unanimous Court in *FPC* v. *Memphis Light, Gas & Water Div.*, 411 U.S. at 465-66.

The Companies presented to the PUC evidence demonstrating that the rate increases they were seeking would not exploit customers. They also presented evidence demonstrating that each proposed rate increase was the minimum required to meet the investor criteria delineated in *Hope*. Notwithstanding the fact that these issues were squarely presented to the PUC in testimony, briefs and oral argument—and despite repeated requests by Met-Ed and Penelec that the PUC make unambiguous findings of fact reflecting its assessment of the impact of its rate order on their customers and investors in order to facilitate judicial review—,* the PUC did not even address these issues in its final rate order. The PUC did not find—and indeed, on the record before it, could not have found—that the rate increases sought by the Companies would exploit customers. Similarly, the PUC did not find—and indeed, on the record before it, could not have found—that the rates which it authorized would assure Met-Ed's and Penelec's financial integrity so as to maintain their credit and to attract capital. Instead, the PUC chose to ignore the subject completely in the ratemaking order which is the subject of this jurisdictional statement.

In their appeals to the Pennsylvania Commonwealth Court and Supreme Court, Met-Ed and Penelec urged that the PUC order was constitutionally invalid because the PUC had not balanced—and did not purport to balance—the consumer and investor interests in the manner required by *Hope* and its progeny.

The Pennsylvania Supreme Court, however, misstated this issue and thereby attributed to the Companies a position they had never

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*In support of such requests, Met-Ed and Penelec cited this Court's statement in *Permian Basin Area Rate Cases*, 390 U.S. at 792:

> "Judicial review of the Commission's orders will therefore function accurately and efficaciously only if the Commission indicates fully and carefully the methods by which, and the purposes for which, it has chosen to act, as well as its assessment of the consequences of its order for the character and future development of the industry."

advocated. For example, the Pennsylvania Supreme Court stated (A4):

> "The issue presented in this appeal is a narrow one, namely whether the decision of the United States Supreme Court in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333 (1944) established a requirement, of constitutional dimension, that utility rates set by regulatory authorities be set at sufficiently high levels as to guarantee, *irrespective of countervailing consumer interests*, the continued financial integrity of the utilities concerned." (emphasis supplied)

This was not the issue as stated by Met-Ed and Penelec. Instead, Met-Ed and Penelec urged before the Pennsylvania Supreme Court that what *Hope* requires is rates which promote the financial integrity of utilities as measured in the manner directed by *Hope, if—but only if*—such rates would not exploit customers.

Similarly, the Pennsylvania Supreme Court elsewhere stated (A6):

> "We do not believe, however, that the *Hope* decision stands for the proposition, urged by Metropolitan Edison and Pennsylvania Electric, that the end result of a rate-making body's adjudication *must* be the setting of rates at a level that will, in any given case, guarantee the continued financial integrity of the utility concerned." (emphasis in original)

But, Met-Ed and Penelec did not urge before the Pennsylvania courts—and do not here urge—that the end result of a rate-making body's adjudication requires the setting of rates at a level that will "in any given case guarantee" the continued financial integrity of the utility. Instead, what Met-Ed and Penelec urged was that, *if such rates would not exploit customers*, the rates established by the rate-making body's adjudication are required to be at a level which will provide an opportunity for the

utility to receive revenues sufficient to meet its operating expenses and capital costs.

Elsewhere in its opinion, the Pennsylvania Supreme Court attributed to Met-Ed and Penelec other positions they did not take. The overall effect of these attributions by the Pennsylvania Supreme Court is to make it appear that Met-Ed and Penelec were urging that the investor interest criteria identified in *Hope* are controlling under all circumstances and that consumer interests are to be ignored. Since that is not a correct analysis of the holding of *Hope*, the Pennsylvania Court then proceeded to reject the position (which it attributed to Met-Ed and Penelec), and then employed that rejection as support for its position that "*Hope* did not establish investor interests of constitutional dimension."

The result is that the Pennsylvania Supreme Court opinion, notwithstanding its extensive quotations from the decisions of this Court in *Hope* and *Permian*, never addressed the issue of whether the PUC was required to balance the interests of consumers and investors within the dual framework prescribed in *Hope*, let alone whether the PUC attempted to achieve such a balance. In this way, the Pennsylvania Supreme Court did not find it necessary to consider whether the rate increases sought by the Companies were in excess of those necessary to preserve their financial integrity or whether, if such rate increases had been granted, the end result would have been to exploit their consumers.

Constitutional and Statutory Provisions Involved

U.S. Const. art. VI, cl. 2:

"This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Con-

stitution or Laws of any State to the Contrary notwithstanding.

U.S. Const. amend. V:

"No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

U.S. Const. amend. XIV, § 1:

". . . nor shall any State deprive any person of . . . property, without due process of law . . ."

Public Utility Code, 66 Pa. C.S. § 1301:

"Every rate made, demanded or received by any public utility shall . . . be just and reasonable . . ."

Statement of the Case

Met-Ed provides electric service to the approximately 830,000 residents of its 3,300 square mile service area, and Penelec to the approximately 1.5 million residents of its 17,600 square mile service area. Together, the Companies provide service in approximately 46% of the land area of Pennsylvania.

The Companies are subsidiaries of General Public Utilities Corporation ("GPU"), a public utility holding company registered under the Public Utility Holding Company Act of 1935. GPU's other public utility subsidiary, Jersey Central Power & Light Company ("Jersey Central"), provides electric service to the approximately 2.4 million residents of its 3,300 square mile service area (comprising about half the land area of New Jersey).

The three subsidiaries own undivided interests in the two Units of the Three Mile Island nuclear generating station ("TMI") as follows: Met-Ed — 50%; Penelec — 25% and Jersey Central — 25%. The accident at TMI-2 occurred on

March 28, 1979, three months after the Unit was placed in commercial service, and made TMI-2 inoperable. Although the TMI-2 accident did not result in damage to TMI-1, the Nuclear Regulatory Commission ("NRC") required that TMI-1 not be operated until authorized by the NRC.*

On July 29, 1980, the Companies filed with the PUC the proposed rate increases which are the subject of these appeals. Although the documents filed in support of such increases included claims for the operating and capital costs of TMI-1 (but not TMI-2), those filings also stated that the Companies believed, on the basis of this Court's decision in *Hope* and its progeny, such increases were justified even if the TMI-1 operating and capital costs were excluded from consideration (as, for example, the allowance of a higher rate of return on those non-TMI-1 investments which the PUC did include in rate base). The test year utilized in these rate increase filings was the twelve month period ended March 31, 1981.

Following these rate increase filings and extending throughout the balance of the test year, continuous declines occurred in the Companies' earnings and interest coverage (the legal tests governing their issuance of bonds and debentures), such declines in the case of Met-Ed being more precipitous than those of Penelec.

Thus, from July 1980 throughout the balance of the test year, Met-Ed was unable to meet the coverage requirements under its indentures and charter for the issuance by it of any additional bonds and debentures and of any preferred stock.

For a few months during the summer of 1980, Penelec had earnings sufficient to have enabled it to meet its indenture requirements for the issuance of some additional long-term debt. It attempted to sell a $50 million issue of first mortgage bonds, but

*After such authorization was received, TMI-1 resumed operation on October 3, 1985.

no purchasers could be found; Penelec "had no access to any permanent capital market" (A35). By the end of the test year, however, Penelec was unable to meet the issuance requirements under its indentures and charter for the issuance by it of any additional bonds, debentures or preferred stock (A34).

When the actual results of Met-Ed's operations during the twelve month period ended March 31, 1981 were adjusted to show receipt of the rate increase allowed under the PUC final order, Met-Ed was unable to meet its indenture requirements for the issuance of additional bonds and debentures (*id.*).

Throughout the proceedings before the PUC, the Companies raised the issue that the PUC rate orders should comply with the *Hope* "end-result" criteria for utility ratemaking. They did so

—in testimony,
—in briefing, and
—in their petition for reconsideration as follows:

> ". . . the Commission has discretion to allow or disallow such costs as a part of a method or formula chosen by it, so long as the end result of the method or formula employed by it satisfy the Constitutional (and equitable) considerations discussed below."

In their respective petitions for review filed with the Commonwealth Court, the Companies averred that the PUC's final order:

> ". . . deprives Petitioner of property without due process of law contrary to the 14th Amendment to the Constitution of the United States and to Article 1, Sections 9 and 10 of the Pennsylvania Constitution in that it does not provide for just and reasonable rates which balance the interests of Petitioner's investors and customers and which are sufficient to assure confidence in Petitioner's financial integrity so as to maintain its credit and to attract capital."

The Companies did not contest before the PUC or the Penn-

sylvania courts the *power* of the PUC to exclude TMI-1 costs from base rates. Rather they urged there, as they do here, that, regardless of the methodology chosen by the PUC, the end result of the PUC's orders must satisfy both the customer and investor interest criteria delineated in *Hope*, if this can be accomplished.

In the proceedings before the PUC and in their appeals to the Commonwealth Court and the Pennsylvania Supreme Court, Met-Ed and Penelec presented unchallenged evidence that, even if their requested rate increases were granted in full, their rates would be in line with those of customers of other utilities in Pennsylvania and neighboring areas. (*See, e.g.*, A33.) Neither the order of the PUC nor the decisions of the Pennsylvania Commonwealth and Supreme Courts suggested that the rates sought by Met-Ed or Penelec would "exploit" their customers. It was also undisputed that Met-Ed and Penelec have continued to render safe, adequate and reliable service.

The Constitutional Question Here Presented Is of Substantial Public Importance

Over 40 years ago, in *Hope*, 320 U.S. 591 (1944), this Court relieved rate regulatory agencies and reviewing courts of the shackles of conformity to particular ratemaking methodologies and formulae.* In so doing, however, this Court also provided the dual consumer-interest and investor-interest criteria by which to ascertain whether the end result of a ratemaking order meets the "just and reasonable" rate standard. More than seventeen years ago, in *Permian*, 390 U.S. 747, 770 (1968), this Court reaffirmed that the "just and reasonable" standard as construed

*This aspect of the decision in *Hope* had been foreshadowed two years earlier by this Court's decision in *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 585-86 (1942), which recognized that the "just and reasonable" standard of the Federal Power Act "coincides with that of the Constitution" and also that "the 'lowest reasonable rate' is one which is not confiscatory in the constitutional sense."

in *Hope* "coincides" with the applicable constitutional standards. More than a decade ago, in *Memphis,* 411 U.S. 458 (1973), this Court unanimously reaffirmed the continuing vitality of the *Hope* criteria and reversed the Court of Appeals for the District of Columbia because that court had ignored the investor-interest component of those criteria.

The decision of the Pennsylvania Supreme Court challenges these holdings. It eliminates any concrete standard by which the results of ratemaking may be evaluated. Under the Pennsylvania Supreme Court's decision, so long as a ratemaking agency merely asserts that it is "balancing investor and consumer interests," there is no function for a reviewing court to perform and no judicial remedy available to assure compliance with the holdings of this Court.

It is a reasonable inference that the Pennsylvania Supreme Court recognized that the result of the PUC's action was to discard the teaching of *Hope*. Certainly, nothing in its opinion contradicts the detailed factual demonstration by the Companies that the PUC's rate order did not satisfy the investor components of the *Hope* criteria. Similarly, nothing in its opinion suggests that the Court believed that the rates requested by Met-Ed and Penelec would be exploitative if granted by the PUC.

The Pennsylvania Supreme Court has not been alone in this regard. As that Court pointed out, the Appellate Division of the Superior Court of New Jersey took similar action in the case of an affiliate of Met-Ed and Penelec. *In Re: Jersey Central Power & Light Co.,* No. A-162-8112 (N.J. Super. Ct. App. Div. July 28, 1983), *cert. denied,* 95 N.J. 217, 470 A.2d 433 (1983), *appeal dismissed for want of a substantial federal question sub nom. Jersey Central Power & Light Co.* v. *Board of Public Utilities,* 466 U.S. 497 (1984). Since these decisions, similar issues have been presented to the United States Court of Appeals for the District of Columbia in a Jersey Central case arising under the Federal Power

Act. Initially, in *Jersey Central Power & Light Co.* v. *Federal Energy Regulatory Commission*, 730 F.2d 816 (D.C. Cir. 1984) ("Jersey Central I"), that Court rejected Jersey Central's views (similar to those here expressed) about the end result requirements of *Hope* in determining "just and reasonable" rates. However, in *Jersey Central Power & Light Co.* v. *Federal Energy Regulatory Commission*, 768 F.2d 1500 (D.C. Cir. 1985) ("Jersey Central II"), that Court granted Jersey Central's petition for rehearing and reversed and vacated its decision in Jersey Central I, essentially adopting the views here expressed. Subsequently, by an Order dated October 18, 1985, 776 F.2d 364, the Court *en banc* granted rehearing and ordered additional briefing and oral argument. (Such additional briefs have been filed, oral argument held and the matter is now awaiting decision by the Court *en banc*.)

While it is necessary to await the decision of the *en banc* Court to ascertain the precedential significance of the *Jersey Central Power & Light Co.* v. *Federal Energy Regulatory Commission* case, the earlier decisions of the Court of Appeals and the interventions in the *en banc* proceeding underscore the importance which is attached to the final resolution of the issues presented.*

The decision of the Pennsylvania Supreme Court in this case, like many other decisions of courts and regulatory commissions in recent years, assumed that the so-called "used and useful principle" of *Smyth* v. *Ames*, 169 U.S. 466 (1898),** has continuing vitality as a Constitutional constraint on the rate actions of regulatory commissions. The Pennsylvania Supreme Court thus failed to recognize that the "used and useful" doctrine in a jurisdiction employing (as do Pennsylvania

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*The intervenors included the National Association of Regulatory Utility Commissions and the National Association of Consumer Advocates.

**The *Smyth* v. *Ames* Court did not employ the term "used and useful", but somewhere along the way that apparently catchy phrase was substituted for the actual phrase employed by the Court.

and New Jersey) an original cost, prudent investment rate base is conceptually violative of *Hope*'s requirements, because it in effect selectively applies a current market value test, after the fact, to project failures, but an original cost test, before the fact, to project successes. It thus permits—as in this case—the fixing of rates at a level inadequate to maintain the utility's financial integrity.

The "used and useful" concept for determining the composition of rate base is generally viewed as attributable to the following statement in *Smyth* v. *Ames,* 169 U.S. at 546-47:

> "We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the *fair value of the property being used by it for the convenience of the public.* And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return *upon the value of that which it employs for the public convenience.*" (emphasis supplied)

The court did not, in *Smyth,* identify the test for determining what "property [was] being used by [the corporation] for the convenience of the public" and, indeed, that issue was not presented in *Smyth* or most of the cases of the pre-*Hope* era in which the "used and useful" phrase was glibly employed. Moreover, in *Smyth,* although the Court held that the rates prescribed by the Nebraska Legislature were unlawful because they would have

deprived the railroads of "the just compensation secured to them by the Constitution," *id.* at 547, the Court did not provide a rationale for limiting rate base to "property being used by [them] for the convenience of the public."

Subsequently, a rationale was supplied by commentators and lower courts, namely, that the utility was entitled to just compensation only for property that was "taken" for the public service and that it could not expect just compensation (*i.e.*, a return) for property which would not be "taken" because it was not "used and useful". Later, when reproduction cost became the favored method for determining rate base, the rationale for limiting rate base to "used and useful" property was that it would be unreasonable to include in rate base (and burden customers with the reproduction cost of) property which no one would think of reproducing.* *See Washington Gas Light Co.* v. *Baker,* 188 F.2d 11, 18 (D.C. Cir. 1950), *cert. denied,* 340 U.S. 952 (1951).

With the decision in *Hope,* the necessity to invoke the "used and useful" doctrine disappeared with the necessity to employ the "fair value" ratemaking methodology required by *Smyth* v. *Ames.* The *Hope* criteria for ascertaining whether the rates prescribed are "just and reasonable" have no necessary, or even rational, nexus to a rate base determined on the basis of "used and useful" property as distinguished from prudent investment. Ratemaking was freed from the shackles of "used and useful" when it was freed from the shackles of *Smyth* v. *Ames* because, as evidenced by the instant proceeding, the "used and useful" test is not necessarily consistent with the *Hope* criteria.

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*In *Los Angeles Gas & Electric Corp.* v. *Railroad Comm'n,* 289 U.S. 287 (1933)—one of the last of the cases in which *Smyth* v. *Ames* was attempted to be applied—the vagaries of such treatment and their rationales were illustrated when the Court upheld a rate order that included in the historical cost measure of value the investment in a manufactured gas facility that was being rendered unnecessary by reason of the introduction of natural gas, but excluded such facility from the reproduction cost measure of value, both of which values were factored into the development of a fair value rate base.

As discussed earlier, the investor components of the *Hope* criteria are related to the financial requirements of the utility, such as the operating and capital costs of the business (including service on the debt and dividends on the stock), return on investment commensurate with those on investments in other enterprises having corresponding risks, and assurance of confidence in the financial integrity of the enterprise so as to maintain its credit and to attract capital.

This Court's review of the end result of the Commission's order in *Hope* was in precisely those terms, such as analysis of *Hope*'s capital account, demonstrated earnings capability, historical and projected dividend-paying capability, ability to make adequate provision for depreciation and depletion, likely future senior capital costs, adequacy of gas supply and the like. *Hope*, 320 U.S. at 603-05. While it is true that the Court reviewed the Commission's rate base determination and its components, there is no indication that they played a controlling role in either the Commission's or Court's decision.

The question of whether, in the light of *Hope*, reviewing courts should continue to create—or not dispute—the impression that rate regulatory bodies are required to employ the "used and useful principle" as a matter of law is important for at least three reasons:

1. The "used and useful principle" is being increasingly invoked to justify a breach of the implicit and fundamental bargain between investors in the securities of electric utilities and the utilities' customers. It is resulting in the expropriation of millions of dollars of investment with no excuse other than the glib "used and useful" phrase.* Assuming that rationality will pre-

*See *Permian*, 390 U.S. at 791 n.60: "The Commission's exercise of its regulatory authority must be assessed in light of its purposes and consequences, and not by references to isolated phrases from previous cases," and *id.* at 775: ". . . this Court does not decide important questions of law by cursory *dicta* inserted in unrelated cases."

vail among investors in the long run, one can anticipate that the cost of electric power will be increased and its availability reduced.

2. Because the inappropriateness of the "used and useful principle" has not been dealt with forthrightly, it has become a rallying issue for those opposed to current rate increases, no matter how well-justified in the long run, and even for legislation enacted in several states. Moreover, the opinion of the Pennsylvania Supreme Court can only be sensibly read as holding that the "used and useful principle" with its *Smyth* v. *Ames* parentage takes precedence over the principle of preserving financial integrity enunciated in *Hope* even when financial integrity can be preserved with nonexploitative rates for customers. But according such a preference is directly contrary to the basic holding in *Hope*.

3. The "used and useful principle" is inherently asymmetrical and unfair when employed to exclude from rate base assets which are not "used and useful", in conjunction with limiting to prudent investment (*i.e.*, depreciated original cost), rather than current market value, those assets that are conceded to be "used and useful".

The Pennsylvania Supreme Court's opinion is correct in stating:

> "The 'used and useful' concept came into existence long before the *Hope* decision was rendered . . ."

Exactly so, and that is because the *Smyth* v. *Ames* "fair value" method of valuation was then being employed in the pre-*Hope* era. But since *Hope*, there has not been a decision of this Court employing the "used and useful" concept. Moreover, the pre-*Hope* decision of this Court in *Denver Union Stock Yard Co.* v. *United States*, 304 U.S. 470, 475 (1938), cited by the Pennsylvania Supreme Court (A3), and similar pre-*Hope* decisions of this Court do not provide support for the "used and useful principle" as employed by the Pennsylvania Supreme Court in this case.

Specifically, *Denver Union* involved a statute authorizing the Secretary of Agriculture to regulate rates for the furnishing of stockyard services. In exercising that authority, the Secretary employed a rate base/rate of return methodology. Certain property was excluded from rate base because it was not, and had never been, property "used and useful" for the performance of the stockyard services covered by the regulated rates; *i.e.*, the excluded property was wholly outside the scope of the statute because it involved an unregulated business. This was also the situation in *St. Joseph Stock Yards Co.* v. *United States*, 298 U.S. 38, 56-60 (1936). And, in *United Gas Public Service Co.* v. *Texas*, 303 U.S. 123, 130, 136, 144 (1938), although the commission and court below questioned the inclusion in rate base of some properties on the ground that they were not used or necessary as standby equipment, such properties were in fact included in rate base, albeit at modestly reduced valuations. Finally, in *Natural Gas Pipeline*, 315 U.S. at 590, the statement made about "used and useful" was of a general nature and not reflective of an issue presented in that case.

In the pre-*Hope* period, it was possible to reconcile the "used and useful" concept with a "fair value" rate base—*i.e.*, a consistent, after-the-fact, basis of valuation was being employed. But, with *Hope*, which is now almost universally implemented in practice (regardless of the phrasing of the valuation basis) by a prudent investment before-the-fact basis of valuation, it is asymmetrical and incongruous to apply an after-the-fact basis of valuation only to certain components of that total valuation—*i.e.* to say that the investor may have included in rate base only the lower of cost or current market value (if any) of each asset, treated separately.

The Court's Historic Role and the National Interest Warrant Review of the Decision Below

During the 44 year period between *Smyth* v. *Ames*, 169 U.S. 466 (1898) and *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575 (1942), the Court heard an unduly large

number of utility rate cases, as it sought to clarify the so-called "rule of *Smyth* v. *Ames*". Justices Brandeis and Holmes were highly critical of these efforts. *See, e.g., Missouri ex rel. Southwestern Bell Telephone Co.* v. *Public Service Commission*, 262 U.S. 276, 289 (1923) (Brandeis, J. dissenting), cited approvingly in *Hope*, 320 U.S. at 603. Yet, they also recognized that investors in public utility securities are constitutionally entitled to a return of, and on, the capital they supplied to the utility so long as the resulting rates are not prohibitive, exorbitant or unduly burdensome to the public. *Southwestern Bell*, 262 U.S. at 290. Although the Court's review of State statutes is limited, *see Ferguson* v. *Skrupa*, 372 U.S. 726, 730-32 (1963), the Court there recognized that State statutes can run afoul of a specific Federal Constitutional requirement and, thereby, be invalid. The Fifth and Fourteenth Amendments are just such specific Federal Constitutional limitations on State action.*

Met-Ed and Penelec respectfully submit that the Pennsylvania Supreme Court's opinion in this case demonstrates that State ratemaking actions have, in recent years, become unhealthily insulated from review by the Court. It is one thing for the Court, quoting Justice Douglas (who was the author of the Court's opinions in both *Hope* and *Memphis*), to refuse to sit as a superlegislature to weigh the wisdom of State legislation. *Ferguson*, 372 U.S. at 731. It is another for the Court to refuse to consider, year after year, the application of Federal Constitutional criteria to ratemaking actions by State agencies and courts.

In *Hope* and *Memphis*, the Court set forth the criteria to be

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*In *Permian*, 390 U.S. at 769-70, the Court recognized once again that the Fifth and Fourteenth Amendments place some limits on the governmental exercise of ratemaking authority, citing *Stone* v. *Farmers' Loan & Trust Co.*, 116 U.S. 307, 331 (1886) and *Covington & Lexington Turnpike Road Co.* v. *Sandford*, 164 U.S. 578, 593 (1896) (both of which involved State ratemaking actions), and that a balancing of consumer and investor interests in accordance with the *Hope* criteria is necessary to pass muster.

employed in determining whether rates meet the "just and reasonable" standard of the Natural Gas Act and, in *Natural Gas Pipeline*, 315 U.S. at 586, and *Permian*, 390 U.S. at 770, held that "the just and reasonable standard of the Natural Gas Act 'coincides' with the applicable constitutional standards." It is abundantly clear that the Pennsylvania Supreme Court has misapplied the teachings of this Court and, in the process, made ephemeral the Constitutional rights of investors long recognized and carefully preserved by this Court.

The Pennsylvania courts are charged not only with the construction of Pennsylvania law. In carrying out their obligations, they must also consider the Federal Constitution and the relevant decisions of this Court which, under the Supremacy Clause, are controlling. Review by this Court is warranted to assure that the Pennsylvania and other State courts fully discharge their federal responsibilities.

Conclusion

The services rendered by electric, gas, telephone, water and other utilities are essential to the health and well-being of the Nation. Their capital requirements far over-shadow those of any other industry. Regulation of their rates and service is singularly pervasive and a demonstration of the awesome power of government. Because that power is primarily wielded at the State, rather than the Federal, level, there is little constraint on its exercise other than that arising from the Fifth and Fourteenth Amendments to the United States Constitution as interpreted by this Court.

The task of the regulators of public utility rates is most difficult, and the public pressures upon them are intense. Their ability to discharge their responsibilities properly will be enhanced, not diminished, by this Court's reminding them, and state appellate courts, of its observation in *Permian*, 390 U.S. at 769:

> "It is, however, plain that the 'power to regulate is not a power to destroy,' *Stone* v. *Farmers' Loan & Trust Co.*, 116 U.S. 307, 331; *Covington & Lexington Turnpike Co.* v. *Sandford, supra, at* 593; and that maximum rates must be calculated for a regulated class in conformity with the pertinent constitutional limitations."

For the foregoing reasons, Appellants respectfully submit that the Federal question here presented is of substantial public importance and was properly presented below, and that this Court should note probable jurisdiction of these appeals.

Respectfully submitted,

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March 7, 1986

APPENDIX

Opinion of the Supreme Court of Pennsylvania, dated December 9, 1985

[J-88-85]

IN THE SUPREME COURT
OF PENNSYLVANIA DISTRICT

PENNSYLVANIA ELECTRIC COMPANY,
Appellant,

—against—

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee,

OFFICE OF CONSUMER ADVOCATE, et al.,
Intervenors.

METROPOLITAN EDISON COMPANY,
Appellant,

—against—

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee,

OFFICE OF CONSUMER ADVOCATE, et al.,
Intervenors.

Nos. 31 & 32 M.D. Appeal Docket 1984

Appeals from the Order of the Commonwealth Court at Nos. 2018 C.D. 1981 and 2019 C.D. 1981 which affirmed the final Order of the Pennsylvania Public Utility Commission at R-80051196 and R-80051197.

78 Pa. Commw. Ct. 402, 467 A.2d 1367 (1983)

ARGUED: May 14, 1985

Opinion of the Supreme Court of Pennsylvania, dated December 9, 1985

Opinion of the Court

FILED: DECEMBER 9, 1985

MR. JUSTICE FLAHERTY

This is an appeal from an order of the Commonwealth Court which affirmed orders of the Pennsylvania Public Utility Commission (PUC) in certain electric utility rate-setting cases. *Pennsylvania Electric Co.* v. *Pennsylvania Public Utility Commission*, 78 Pa. Commw. Ct. 402, 467 A.2d 1367 (1983). The cases arose as repercussions of the 1979 accident at the Three Mile Island nuclear generating station near Harrisburg, Pennsylvania. The accident involved the near melt-down of a nuclear reactor, and was the most serious in the history of nuclear power generating facilities in the United States. The Three Mile Island incident has had nationwide implications, not only with respect to the future of nuclear power generation in the United States, but also in relation to the resultingly imperiled financial viability of some of our nation's largest public utility companies. It is with this latter aspect of the incident, as regards the diminished financial viability of the companies that own the Three Mile Island station, that the instant appeal is concerned.

The appellants, Metropolitan Edison Company and Pennsylvania Electric Company, own 50% and 25% interests, respectively, in the Three Mile Island station. In 1979, shortly after the nuclear accident, the PUC set reduced permanent rates for these companies, and these new rates reflected the removal from the rate base of all costs associated with Unit 2, the unit involved in the accident, on the basis that Unit 2 had been so severely damaged as to render it no longer useful in the public service. This action was in accord with well-established principles that rates charged the public for utility services are to provide a re-

turn upon only such property of the utility as is used and useful in the public service. See 66 Pa.C.S.A. §1310(d) (utility entitled to "fair return upon the fair value of the property of such public utility, used and useful in its public service . . . ."); *Scranton* v. *Scranton Steam Heat Co.*, 405 Pa. 397, 401, 176 A.2d 86, 88 (1961). See also *Denver Union Stock Yard Co.* v. *United States*, 304 U.S. 470, 475, 58 S.Ct. 990, 82 L.Ed. 1469, 1475-1476 (1938) (Under the due process clause of the Fifth Amendment, a regulated utility "is entitled to rates, not per se excessive and extortionate, sufficient to yield a reasonable rate of return upon the value of property used, at the time it is being used, to render the services. But it is not entitled to have included any property not used and useful for that purpose." (citations omitted)).

At the time of the accident at Unit 2, another nuclear reactor at Three Mile Island, Unit 1, had been shut down for refueling. Following the accident at Unit 2, Unit 1 remained shut down by order of the Federal Nuclear Regulatory Commission. Shortly after ordering reduced rates based on the lack of continued usefulness of Unit 2, the PUC, in 1980, made a determination that Unit 1 was likewise no longer useful in the public service, because its return to service was not "imminent" or "certain," and, accordingly, the PUC established temporary reduced rates, reflecting the exclusion of all costs associated with Unit 1 from the companies' rate bases. These temporary reduced rates for Metropolitan Edison and Pennsylvania Electric were, on an annual basis, $26.9 million and $11.7 million less, respectively, than their existing rates. The companies filed complaints alleging that these new rates were unjust and unreasonable, and filed tariffs seeking substantial rate increases. In these tariffs, the companies sought to include in their rate bases costs and investments related to Unit 1, but the companies have not sought in this case to do the same with respect to the damaged reactor, Unit 2. Hearings were held before an Administrative Law Judge, and the decisions recom-

mended by the Administrative Law Judge were adopted, with only minor modifications, by the PUC in 1981. The final PUC orders allowed Metropolitan Edison a rate increase, over and above the challenged temporary rates, of nearly $52 million (including $11 million covering Unit 1 restart costs). Pennsylvania Electric was awarded an increase, over and above the temporary rates, of approximately $55.5 million (including $5.5 million covering Unit 1 restart costs). Metropolitan Edison and Pennsylvania Electric had sought larger rate increases, of $76.4 million and $67.4 million respectively. Appeals were taken to the Commonwealth Court, where the orders of the PUC were affirmed. The instant appeal ensued.

The issue presented in this appeal is a narrow one, namely whether the decision of the United States Supreme Court in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944) established a requirement, of constitutional dimension, that utility rates set by regulatory authorities be set at sufficiently high levels as to guarantee, irrespective of countervailing consumer interests, the continued financial integrity of the utilities concerned. In *Hope*, the United States Supreme Court addressed the considerations to be taken into account by the Federal Power Commission in setting "just and reasonable" rates for natural gas companies, as required under §4(a) of the Natural Gas Act, 15 U.S.C. §717. The Court noted that there were no applicable constitutional requirements more exacting than the requirement of "just and reasonable" rates set forth in the Act. 320 U.S. at 607, 88 L.Ed. at 347. Indeed, in the Court's subsequent decision in *Permian Basin Area Rate Cases*, 390 U.S. 747, 770, 88 S.Ct. 1344, 20 L.Ed.2d 312, 338 (1968), *reh. den.* 392 U.S. 917 (1968), it was held that "the *just and reasonable* standard of the Natural Gas Act *'coincides'* with the *applicable constitutional standards* . . . and any rate selected by the Commission from the broad zone of reasonable-

ness permitted by the Act cannot properly be attacked as confiscatory." (emphasis added) (citation omitted). See also *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 585-586, 62 S.Ct. 736, 86 L.Ed. 1037, 1049 (1942). It is to be noted that the constitutionally based requirement of "just and reasonable" rates, under the Fifth and Fourteenth Amendments, is in effect embodied in terminology found in the Pennsylvania Public Utility Law, which governs the rates being challenged in the instant appeal. Indeed, in *Pennsylvania Public Utility Commission* v. *Pennsylvania Gas and Water Co.*, 492 Pa. 326, 337, 424 A.2d 1213, 1219 (1980), *cert. den.* 454 U.S. 824 (1981), we stated that the requirement of "just and reasonable" rates set forth in the Public Utility Law, 66 P.S. §1141 (repealed 1978; reenacted at 66 Pa. C.S.A. §1301), "confer(s) upon the regulatory body the power to make and apply policy concerning the appropriate *balance* between prices charged to utility customers and returns on capital to utility investors *consonant with constitutional protections* applicable to both." (emphasis added).

In discussing the considerations to be taken into account in applying the standard requiring "just and reasonable" rates, the Court, in *Hope*, emphasized that the focus of inquiry is properly upon the end result or "total effect" of the rate order, rather than upon the rate-setting method employed. 320 U.S. at 602, 88 L.Ed. at 345. Describing the rate-setting process as a balancing process, involving the weighing of certain enumerated interests of the consumer and of the investor, the Court stated the following:

> The rate-making process under the Act, i.e., the fixing of "just and reasonable" rates, involves a *balancing of the investor and the consumer interests.* Thus we stated in the Natural Gas Pipeline Co. Case that "regulation does not insure that the business shall produce net revenues." . . . [T]he *investor interest has a legitimate concern with the financial*

> *integrity of the company* whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. . . . By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. . . . The conditions under which more or less might be allowed are not important here.

320 U.S. at 603, 88 L.Ed. at 345. In short, *Hope* sets forth a balancing test, like that which we described in *Pennsylvania Gas, supra,* for the determination of "just and reasonable" rates, to be applied with the aim of protecting consumers against exploitation at the hands of utility companies while seeking to preserve the financial integrity of utility companies. See *Federal Power Commission* v. *Memphis Light, Gas & Water Division,* 411 U.S. 458, 465-466, 93 S.Ct. 1723, 36 L.Ed.2d 426, 433 (1973). We do not believe, however, that the *Hope* decision stands for the proposition, urged by Metropolitan Edison and Pennsylvania Electric, that the end result of a rate-making body's adjudication *must* be the setting of rates at a level that will, in any given case, guarantee the continued financial integrity of the utility concerned.

Rather, the *Hope* decision requires only that the regulatory authority balance competing consumer and investor interests to determine "just and reasonable" rates. *Permian Basin Rate Cases,* 390 U.S. at 770, 20 L.Ed.2d at 338 ("[T]here can be no constitutional objection if the Commission, in its calculation of rates, takes fully into account the various interests which Congress has

required it to reconcile. . . . [S]uch rates . . . intended to 'balanc[e] . . . the investor and the consumer interests,' are constitutionally permissible. *FPC* v. *Hope Natural Gas Co., supra,* at 603, 88 L.Ed. at 345."). The *Hope* decision does not indicate, however, that the investor interests described in the quoted excerpt from *Hope, supra,* are to supersede those of consumers in any case where what would otherwise be a "just and reasonable" rate would endanger the financial integrity of the utility. To conclude otherwise would be to elevate the investor interests to a constitutionally guaranteed dimension, a result which was not indicated by *Hope* and its progeny.

The decision in *Hope* enumerated certain legitimate areas of concern for investors, these being that a company have sufficient revenue to cover operating and capital costs, that the return on equity be commensurate with returns on enterprises having similar risks, and that the company be able to maintain credit and attract capital. These investor interests are appropriate factors to be weighed in the balancing analysis under *Hope*, but they are not, in themselves, controlling, for other factors must be taken into account. As stated in *Permian Basin Area Rate Cases,* 390 U.S. at 790-791, 20 L.Ed.2d at 350,

> [The investor-interest criteria] remain pertinent, but they scarcely exhaust the relevant considerations.
>
> The Commission cannot confine its inquiries either to the computation of costs of service or to conjectures about the prospective responses of the capital market; it is instead obliged at each step of its regulatory process to *assess the requirements of the broad public interests* entrusted to its protection by Congress. Accordingly, the "end result" of the Commission's orders must be measured as much by the success with which they protect those interests as by the effec-

> tiveness with which they "maintain credit . . . and . . . attract capital."

(emphasis added) (footnote omitted). We find no authority, in *Hope* or in other decisions, indicating that broad public interests are to yield to the interests of investors whenever the financial integrity of a utility company is imperiled.

In cases where the balancing of consumer interests against the interests of investors causes rates to be set at a "just and reasonable" level which is insufficient to ensure the continued financial integrity of the utility, it may simply be said that the utility has encountered one of the risks that imperil any business enterprise, namely the risk of financial failure. The express language of the *Hope* decision weighs against regarding utilities as a protected class of business enterprises which are to be relieved of such normal business risks. Specifically, it was stated in *Hope,* 320 U.S. at 603, 88 L.Ed. at 345, that investment returns to utility owners "should be commensurate with returns on investments in other enterprises having corresponding *risks.*" (emphasis added). In addition, the *Hope* decision observed, " 'regulation does not insure that the business shall produce net revenues,' [quoting *Federal Power Commission* v. *Natural Gas Pipeline Co.,* 315 U.S. 575, 590, 62 S.Ct. 736, 86 L.Ed. 1037, 1052 (1942)]." 320 U.S. at 603, 88 L.Ed. at 345. The risks which utilities are to bear were further noted in *Natural Gas Pipeline,* 315 U.S. at 590, 86 L.Ed. at 1052, where it was stated that "the hazard that the property will not earn a profit remains on the company in the case of a regulated, as well as an unregulated business." Since the risk of non-profitability remains upon regulated utility companies, it follows that the consequence of that lack of profitability, to wit diminished financial integrity, also rests upon utility companies. Indeed, the *Hope* decision accorded implicit recognition to the fact that, in determining "just and reasonable" rates,

there may be circumstances in which investor interests in the financial integrity of the enterprise may fail to be fulfilled, for after noting the interest in providing rates of return that preserve financial integrity, the decision stated that the case before it was not one where it was important to address the "conditions under which more or less might be allowed . . . ." 320 U.S. at 603, 88 L.Ed. at 345.

If the impact of diminished financial integrity were shifted from utility companies to the consumers, as would be the case if the utilities were regarded as having a constitutionally guaranteed right to rates which would preserve their financial integrity, elevating their rates above those levels that would otherwise be regarded as providing a "just and reasonable" return on assets utilized in the public service, the result would effectively circumvent the longstanding principle, discussed *supra*, that property included in a rate base must be "used and useful" in the public service. Specifically, rate bases which had been determined through the exclusion of non-useful property would be rendered superfluous because the resulting rates would have to be adjusted upwards, whenever the financial integrity of the enterprise was in peril, and the effect upon rates would be the same as if portions of the non-useful property, such as the Three Mile Island nuclear reactors, had not been excluded from the rate base in the first instance.

The "used and useful" concept came into existence long before the *Hope* decision was rendered, and it is not generally regarded as having been overridden by that decision. The concept continues to be of application in this Commonwealth. *Barasch* v. *Pennsylvania Public Utility Commission*, ____ Pa. ____, 490 A.2d 806 (1985). Recently, in *Barasch* v. *Public Utility Commission*, ____ Pa. ____, 491 A.2d 94, 104 (1985), we noted the legislature's longstanding policy that current ratepayers should shoulder only

the costs of providing current utility service, with such costs to be determined by reference to such property as is "used and useful" in service to the public. Though not a decision focusing upon whether preservation of the financial integrity of a utility is constitutional to be accorded precedence over adherence to the "used and useful" principle, the *Barash* decision did set forth the following observations regarding the priority to be accorded the "used and useful" concept:

> Arguably tomorrow's consumers may be better served by requiring current ratepayers to infuse interest-free capital into our utilities through the collection of excess expenses from today's ratepayers. This may also reduce the need for additional borrowing in the capital market, improve the bond rating of utilities and lower the cost rate for common equity. However, if utility rates are to reflect such a capitalization requirement from current consumers to protect the financial integrity of the system for the future, that is a matter for the Legislature, not the courts or the Commission, to decide.

____ Pa. at ____, 491 A.2d at 104.

The "used and useful" principle is soundly based, for it serves to protect consumers from exploitation, and it comports with the view that, in fairness, consumers should not be required to buoy up failing utility companies by being required to, in effect, provide public subsidies for utility properties that are not useful in the public service. If the *Hope* decision were to be interpreted as providing constitutional guarantees for the achievement of investor interests, the "used and useful" principle would have to yield, at least in exceptional situations where the financial integrity of a utility is imperiled, but we do not perceive from *Hope* that investor interests are to be accorded such a guaranteed status.

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In summary, therefore, we hold that the *Hope* decision is to be interpreted as recognizing a constitutional requirement of "just and reasonable" utility rates, providing a return on used and useful property, with rates to be determined through a balancing of consumer and investor interests. The legitimate areas of investor concern, enumerated in *Hope*, are not, however, of constitutional dimension, but are among the factors to be taken into account in the balancing of interests process.[1]

Aside from the analysis heretofore presented, additional and independent support for this holding may be discerned from the action of the Supreme Court of the United States in regard to a decision of the Appellate Division of the Superior Court of New Jersey. In the case of *In re: Jersey Central Power & Light Co.*, No. A-162-81T2 (July 28, 1983), *cert. den.* 95 N.J. 217, 470 A.2d 433 (1983), the Superior Court of New Jersey was presented with facts, and legal issues, that were precisely the same in all relevant respects as those of the instant case. Specifically, Jersey Central Power and Light Company challenged rates set by the Board of Public Utilities, after the Board had excluded from the rate base the company's 25% ownership interest in the non-useful Unit 1 reactor at Three Mile Island. Asserting a jeopardized financial status, the company raised the same argument, based on *Hope*, as Metropolitan Edison and Pennsylvania Electric have raised in the present case, namely that the investor in-

[1]Examination of the instant PUC decisions reveals that they reflect a balancing of consumer and investor interests. Metropolitan Edison and Pennsylvania Electric seek to have this case remanded to the PUC for further findings of fact, however, asserting that the findings of fact heretofore submitted by the PUC, pursuant 66 Pa.C.S.A. §703(e), are insufficient to permit appellate review as to whether constitutionally guaranteed investor interests set forth in *Hope* have been satisfied by the PUC's rate orders. In view of our determination that *Hope* did not establish investor interests of constitutional dimension, any need for such a remand has been obviated.

terests enumerated in *Hope* are of constitutional dimension. The Superior Court of New Jersey rejected that assertion, and announced a holding *identical* to that which we have reached presently.

The Supreme Court of New Jersey declined to review the decision, and an appeal was taken to the Supreme Court of the United States. That appeal was subsequently dismissed for want of a substantial federal question. *Jersey Central Power & Light Co. v. Board of Public Utilities*, ____ U.S. ____, 104 S.Ct. 2146, 80 L.Ed.2d 533 (1984). Unlike the grant or denial of certiorari, which expresses no intimation as to the merits of a case, a dismissal for want of a substantial federal question is, like a summary affirmance, a decision on the merits. *Ohio ex rel. Eaton* v. *Price*, 360 U.S. 246, 247, 79 S.Ct. 978, 3 L.Ed.2d 1200, 1202-1203 (1959) (opinion of Mr. Justice Brennan). See also *Appeal of Kartorie*, 486 Pa. 500, 503, 406 A.2d 746, 747-748 (1979). The Supreme Court of the United States has, therefore, through dismissal of the *Jersey Central* appeal, stated implicitly its approval of the holding in that case, and our holding in the instant case is identical to that which was approved in *Jersey Central*.

Order affirmed.

Mr. JUSTICE HUTCHINSON did not participate in the consideration or decision of this case.

MR. JUSTICE PAPADAKOS concurs in the result.

JUDGMENT

ON CONSIDERATION WHEREOF, It is now hereby ordered and adjudged by this Court that the Order of the Commonwealth Court is affirmed.

MILDRED E. WILLIAMSON
DEPUTY PROTHONOTARY

DATED: DECEMBER 9, 1985

Opinion of the Commonwealth Court of Pennsylvania, dated November 18, 1983

PENNSYLVANIA ELECTRIC COMPANY,

Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,

Respondent,

OFFICE OF CONSUMER ADVOCATE et al.,

Intervenors.

PENNSYLVANIA ELECTRIC COMPANY,

Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,

Respondent,

OFFICE OF CONSUMER ADVOCATE,

Intervenor.

METROPOLITAN EDISON COMPANY,

Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,

Respondent,

OFFICE OF CONSUMER ADVOCATE et al.,

Intervenors.

Commonwealth Court of Pennsylvania.

Argued Nov. 16, 1982.
Decided Nov. 18, 1983.

Samuel B. Russell, Ryan, Russell & McConaghy, Reading, Ashley Schannauer, Pittsburgh, W.E. Ogden, Reading, for petitioner in No. 1645 C.D. 1981.

Opinion of the Commonwealth Court of Pennsylvania, dated November 18, 1983

David Barasch, Craig Burgraff, Maurice A. Frater, McNees, Wallace & Nurick, Harrisburg, Stanley H. Siegel, Siegel & Siegel, Lewistown, for Office of Consumer Advocate.

Bohdan R. Pankiw, Steven A. McClaren, Joseph J. Malatesta, Jr., Harrisburg, for Public Utility Com'n.

John M. Quain, North Wales, for American Society of Utility Investors.

Before CRUMLISH, President Judge, and ROGERS, BLATT, WILLIAMS and MacPHAIL, JJ.

OPINION

CRUMLISH, President Judge.

We have consolidated for argument and disposition the four appeals of Pennsylvania Electric Company (Penelec) and Metropolitan Edison Company (Met-Ed) from four orders of the Public Utility Commission (Commission) entered June 8, 1981 and July 27, 1981. The two Commission orders entered June 8, 1981 dismissed the complaints of Penelec and Met-Ed against temporary rates previously fixed by the Commission by orders entered May 23, 1980. The two Commission orders of July 27, 1981, allowed Penelec and Met-Ed annual rate increases of $55,445,000 and $51,804,000, respectively. We affirm.

HISTORY OF THE CASE

This proceeding is another repercussion of the March 28, 1979 accident at the Three Mile Island nuclear-powered generating station Unit No. 2 (TMI-2). Met-Ed and Penelec own a 50%

and 25% interest, respectively, in the generating station.[1] In response to the accident, the Commission set temporary rates for Met-Ed on April 19, 1979 and for Penelec on April 25, 1979, reflecting the removal of TMI-2 related costs. The Commission adopted an order on June 15, 1979, concluding in part that TMI-2 was no longer used and useful in public service and all costs associated with that unit must be removed from rates.[2] Pursuant to this conclusion, the Commission made permanent the temporary rates then in effect.

At the time of the accident, Unit No. 1 (TMI-1) had been shut down for refueling. On September 20, 1979, the Commission ordered Met-Ed and Penelec to show cause why TMI-1 should be considered used and useful and why all costs associated therewith should not be removed from rates.[3] On November 27, 1979, Met-Ed and Penelec proposed that a future test year be utilized to provide the necessary factual basis for revision of the rates of the companies if TMI-1 were to be removed from their respective rates. In a pre-hearing order adopted December 21, 1979, the Commission declined to set a test year for such purposes on the grounds that the level of just and reasonable rates for Met-Ed and Penelec were not then an issue before the Commission in that proceeding.

By order of May 23, 1980, the Commission determined that

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[1]Except for the figures involved, the arguments of Met-Ed and Penelec are identical. The utilities will be referred to collectively as "companies."

[2]A public utility is allowed to charge rates which will permit it to earn a fair return on the fair value of its property which is used and useful in the public service. *See Bell Telephone Co. of Pennsylvania* v. *Pennsylvania Public Utility Commission,* 47 Pa. Commonwealth Ct. 614, 408 A.2d 917 (1979).

[3]TMI-1 has remained shut down by order of the Federal Nuclear Regulatory Commission.

TMI-1 was not used or useful in the public service. Accordingly, TMI-1 was excluded from the rate bases of Met-Ed and Penelec. Pursuant to Section 1310 of the Public Code (Code), 66 Pa. C.S. §1310, the Commission established temporary rates for Met-Ed and Penelec at an annual level which was $26.9 million and $11.7 million, respectively, less than their existing rates. This decrease reflected the exclusion of TMI-1 from the companies' rate bases.

On July 29, 1980, both Met-Ed and Penelec filed complaints against the respective temporary rates, alleging that these temporary rates were unjust and unreasonable. Pursuant to Section 1308(d) of the Code, Met-Ed and Penelec also filed Tariff No. 44 seeking a $76.4 million increase in rates and Tariff No. 75, seeking a $67.4 million increase in rates, respectively. Testimony was taken before the ALJ on twenty-two days between October 20, 1980 and January 23, 1981. The ALJ recommended in his March 20, 1981 decision that Met-Ed's and Penelec's complaints against temporary rates be dismissed. The Commission's order of June 8, 1981, adopted this decision. The Commission's final orders of July 27, 1981, allowed Met-Ed an annual rate increase of $51,804,000 (including $11 million covering TMI-1 restart costs) over and above the temporary rates and allowed Penelec an annual rate increase of $55,445,000 (including $5.5 million covering TMI-1 restart costs) over and above the temporary rates.

The companies have raised a number of issues on appeal. First, with regard to the temporary rates, the companies contend that the record compels the conclusion that they have proven the need for an increase in the level of their temporary rates of at least $11.7 million for Penelec and $26.9 million for Met-Ed. Further, the companies contend that retroactive recoupment is required in connection with any shortfall which is found to exist in the

adequacy of the Commission fixed temporary rates. Second, the companies contend that the final rates under the July 27, 1981 order are not just and reasonable pursuant to statutory and constitutional standards. Third, the companies pray that the Commission's order of July 27, 1981, should be clarified to ensure that benefits of present reserve capacity expense credits shall flow in the future only to those parties who are reasonably entitled to those benefits.

Our scope of review is limited to a determination of whether constitutional rights have been violated, an error of law has been committed, or the findings or order of the Commission are not supported by substantial evidence. *Park Towne* v. *Pennsylvania Public Utility Commission,* 61 Pa. Commonwealth Ct. 285, 289, 433 A.2d 610, 613 (1981).

TEMPORARY RATE INCREASE

The companies' argument as to the Commission's fixed temporary rates is twofold. They contend first that the ALJ's findings as adopted by the Commission are inconsistent; and second, that retroactive recoupment is required in connection with any shortfall which is found to exist in the adequacy of the temporary rates. The alleged inconsistency lies in that the ALJ found, based on the future test year ending March 31, 1981, the annual revenue requirements of Penelec and Met-Ed to be $54,890,000 and $49,789,000 above the temporary rates. Yet, he also found that neither Met-Ed nor Penelec met their burden of showing that the temporary rates were not just and reasonable.

We hold that the ALJ's finding as to the future test year revenue requirements entitles the companies to prospective rate relief only. The fact that the Commission has granted a prospective rate increase does not establish the unreasonableness of the lower tem-

porary rates previously in effect. *See Pendergast* v. *New York Telephone Co.*, 262 U.S. 43, 43 S.Ct. 466, 67 L.Ed. 853 (1923). Indeed, the very reason for the lower temporary rates was continued and followed by the Commission in its granting of the permanent rate increases. Just as the operating expenses and capital costs of TMI-1 were removed from the companies' then-existing rate bases to establish the temporary rates, these expenses and costs were not included in the rate bases to determine the permanent rate increases granted by the Commission.

The companies also submit that retroactive recoupment is required in connection with any shortfall which is found to exist in the adequacy of the Commission's fixed temporary rates. They argue that, since the Commission endorsed the ALJ's recommended finding as to the required permanent rate increases, there are shortfalls, *per se*, in the level of the temporary rates. Therefore, they contend that they should be able to recoup, at the very least, $26.9 million for Met-Ed and $11.7 million for Penelec of these shortfalls.

Section 1310 of the Code does create a "retroactive ratemaking mechanism by requiring the Commission to consider the effect of inadequate rates set on a temporary basis when fixing the amount of permanent rates thereafter approved." *See Bell Telephone Co. of Pennsylvania* v. *Pennsylvania Public Utility Commission*, 69 Pa. Commonwealth Ct. 554, 560, 452 A.2d 86, 89 (1982) (footnote omitted). Section 1310(e) provides, in part:

> In every proceeding in which temporary rates are fixed, determined, and prescribed under this section, the commission shall consider the effect of such rates in fixing, determining, and prescribing rates to be thereafter demanded or received by such public utility on final determination of the rate proceeding.

Opinion of the Commonwealth Court of Pennsylvania, dated November 18, 1983

The companies have not sustained their burden of showing that the Commission did not consider the effect of the temporary rates.[4] Under Section 1310(d) of the Code, whenever the Commission is of the opinion that rates of a utility are producing a return in excess of a fair rate of return, it may prescribe temporary rates that will produce a fair return. In the case *sub judice*, the Commission, having found that TMI-1 was no longer "used or useful," removed TMI-1's capital costs and operating expenses from the rate bases and properly prescribed lower temporary rates producing fair rates of return on the lower rate bases. The record shows that the rates of return clearly exceeded the minimum statutory standard of 5%.[5] Thus, the temporary rates were proper *ab initio*. In granting the permanent prospective rates under Sec-

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[4]Commissioner Michael Johnson stated in his concurring opinion to the order adopting the ALJ's recommended decision:

> [The companies' argument] ignores the Commission's discretion to adjust rates that have been based on a future test year where the supporting documentation has been proven to be significantly in error. It ignores the fact that the Commission has provided for full and current recovery of replacement and purchased power expenses and the fact that the revenues associated with TMI-1 had been continually collected in base rates while the unit was out of service through May 1980, fourteen months after its scheduled return to service[,] . . . eight months after the Commission issued the used and useful show cause order, and it ignores the fact that the unit was included in base rates for five months beyond the period originally accepted by the Commission for its reasonable return to service. Furthermore, in the consolidated general rate proceedings the Commission has authorized both utilities to restate the respective depreciation reserves associated with both Three Mile Island units. . . .
> . . . The ratepayers cannot be held accountable in this temporary rate complaint proceeding for the attrition of earnings that is and has been properly accounted for in the accompanying general rate proceeding.

[5]Section 1310(c) of the Public Utility Code.

tion 1308, TMI-1's capital costs and operating expenses were still excluded from the rate bases entitling the companies to no retroactive recoupment. Indeed, financial problems caused by the removal of TMI-1 from the rate bases were addressed and relieved by provisions in the permanent rate increases.

THE FINAL RATE ORDER

The companies' second major argument on appeal is that the final rates were not just and reasonable pursuant to statutory and constitutional requirements. The companies contend that the disallowance of the great bulk of the capital costs and operating expenses of TMI-1 from the rate base on the ground that the unit was not used and useful in public service forced investors and shareholders to bear expenses which should have been borne by the utilities' ratepayers as a whole.

The Commission's exclusion of capital costs and operating expenses of TMI-1 was proper. In *Philadelphia Electric Co.* v. *Pennsylvania Public Utility Commission*, 61 Pa. Commonwealth Ct. 325, 329, 433 A.2d 620, 623 (1981), we stated:

> The touchstone for determining whether or not a prudently constructed unit should be included in a utility's rate base is whether or not, during the test year involved the unit will be used and useful in rendering service to the public.

"What constitutes used and useful utility property is committed to the discretion of the Commission." *Bell Telephone Co. of Pennsylvania* v. *Pennsylvania Public Utility Commission*, 47 Pa. Commonwealth Ct. 614, 629, 408 A.2d 917, 925 (1979). Further, the burden is on the utility to establish that the property sought to be included is used and useful in the public service. *Id.* at 629, 408 A.2d at 925. We are not persuaded that the companies have carried this burden.

Opinion of the Commonwealth Court of Pennsylvania, dated November 18, 1983

The companies rely on the decision of our Supreme Court in *Pennsylvania Public Utility Commission* v. *Pennsylvania Gas & Water Co.*, 492 Pa. 326, 424 A.2d 1213 (1980), to support a "pragmatic adjustment" theory applied by Federal Courts as expressed in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944).[6] We do not, however, interpret our Supreme Court's decision in *Pennsylvania Gas & Water Co.* as rejecting the traditional rate-making principles espoused in *Bell of Pennsylvania* and *Philadelphia Electric Co.* As this Court stated in *Dauphin Consolidated Water Supply Co.* v. *Pennsylvania Public Utility Commission*, 55 Pa. Commonwealth Ct. 624, 628, 423 A.2d 1357, 1359 (1980):

> The thrust of [Pennsylvania Gas & Water] was to dispel any assumption of a constitutionally-mandated nexus between fair value and cost of reproduction or trended original cost figures. . . . However, [its] functional effect was to put the economic theories and policies underlying public utility property valuations strictly in the hands of the Commission so long as fair value was set somewhere between original cost and trended original cost. (Citations omitted.)

We find that the Commission did not abuse its discretion in finding that TMI-1 was not used or useful and thus in excluding its capital and operating costs from the rate bases. The actions of the Commission do reflect a balancing of investor and consumer interests as prescribed by the Supreme Court in *Pennsylvania Gas & Water Co.* The allowed increase for Penelec included $5.5 million for TMI-1 related costs and reflected a 16.5% rate of return on common equity capital. The allowed increase for Met-Ed included $11 million for TMI-1 related costs and reflected a

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[6]This Court rejected the *Hope* doctrine in *West Penn. Power Co.* v. *Pennsylvania Public Utility Commission*, 33 Pa. Commonwealth Ct. 403, 381 A.2d 1337 (1978).

17% rate of return on common equity capital. This is the highest rate ever allowed a Pennsylvania utility.[7] Further, TMI-1 was out of service for a full 14 months before its capital costs and operating expenses were excluded from the companies' rate bases. Finally, the Commission normalized the reserve capacity expense credits, discussed *infra*, which allowed the reserve capacity expense to be shown in the test year as $11.4 million higher than the actual reserve capacity expense. For these reasons, we find the Commission properly balanced investor and consumer interests in excluding TMI-1 capital costs and operating expenses from the companies' rate bases.[8]

NORMALIZATION OF THE RESERVE CAPACITY EXPENSE

The companies' final argument on appeal is that the Commission's order of July 27, 1981, should be clarified to ensure that benefits of present reserve capacity expense credits shall flow in the future only to those parties who are reasonably entitled to those benefits.

The companies participate in power-pooling agreements which require that the member utilities maintain certain levels of reserve generating capacity. In the absence of such reserves, the defaulting utility must make reserve capacity payments to those utilities

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[7]Respondent's brief, p. 39.

[8]In *In Re Jersey Central Power & Light Petition*, 85 N.J. 520, 428 A.2d 498 (1981), the Supreme Court of New Jersey found that TMI-1 was properly removed from Jersey Central Power & Light Company's rate base. This company, also a subsidiary of General Public Utility Corporation, owns the remaining 25% interest in the Three Mile Island Generating Station. The Court rejected the company's argument that the utility board did not give attention to all relevant factors, such as its financial problems.

whose generating reserves help to make up its shortfall. There is a three-year lag provision in the agreements. In the general rate increase proceeding, the reserve capacity expenses claimed by the companies did not reflect a $11.4 million and $23.1 million credit available to Penelec and Met-Ed, respectively, for the twelve-month period ending March 31, 1981 (the future test year). Thus, the claimed reserve capacity expenses figured in the rate base were $11.4 million and $23.1 million higher than the actual reserve capacity expense. The Commission determined that, due to the companies' financial difficulties, these current credits should be normalized rather than reflected in customer rates.

The companies contend that the benefits from these credits should only go to those who bear the capital cost of the units. They argue that the benefits should only go to the ratepayers when TMI-1 and TMI-2 capital costs are included in the companies' rate bases. According to the companies, at such time when the capital costs are again included in the rate bases, the normalization reserve would be drawn upon to the extent required so that the ratepayers in that future period shall receive the full normal credit against reserve capacity expense which that unit would then provide had there been no intervening outages. Any excess normalization reserve would inure to the benefit of the companies.

The companies ignore the fact that the current reserve capacity expense credits are based on a lagging three-year historical average. Thus, the $11.4 million and $23.1 million credits for the future test year are actually associated with prior periods, where full capital costs of TMI-1 and TMI-2 were reflected in customers' rates. By normalizing the expense credits, the Commission has allowed, in effect, an interest-free loan by customers to the utilities. "The Commission has a wide area of discretion with respect to the extent and type of adjustments which it [can] make to test

year data providing there is substantial evidence in the record warranting its action." *Pittsburgh* v. *Pennsylvania Public Utility Commission*, 182 Pa.Superior Ct. 551, 560, 128 A.2d 372, 376 (1956). The Commission contends that it is within its discretion to order the normalization of these credits to strike a balance between investor and consumer interests.[9] We agree. The normalization of these credits reflected an awareness of the financial difficulties of the utilities while at the same time recognizing the ratepayers' eventual claim to the credits.

Affirmed.

ORDER

The orders of the Pennsylvania Public Utility Commission entered June 8, 1981, dismissing the complaints of Pennsylvania Electric Company at C-80072106 and Metropolitan Edison Company at C-80072105, are affirmed.

The orders of the Pennsylvania Public Utility Commission entered July 27, 1981, granting, in part, the requested rate increases of Pennsylvania Electric Company at R-80051197 and Metropolitan Edison Company at R-80051196, are affirmed.

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[9]The Commission rejected the argument of the Office of Consumer Advocate that the present rates should reflect only actual reserve capacity expense.

Order of the Pennsylvania Public Utility Commission, entered July 27, 1981

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, Pa. 17120

Public Meeting held July 24, 1981

Commissioners Present:
Susan M. Shanaman, Chairman
Michael Johnson
James H. Cawley
Linda C. Taliaferro

PENNSYLVANIA PUBLIC UTILITY COMMISSION
R-80051196

v.

METROPOLITAN EDISON COMPANY

PENNSYLVANIA PUBLIC UTILITY COMMISSION
R-80051197

v.

PENNSYLVANIA ELECTRIC COMPANY

OPINION AND ORDER

BY THE COMMISSION:

On April 24, 1981, the Respondents filed a joint petition for reconsideration and modification of orders entered at the above-captioned dockets on April 9, 1981. On May 4, 1981, the Office of Consumer Advocate filed an answer, and on May 11, 1981, the Trial Staff filed its answer. The Trial Staff noted that its answer was not filed within the 10 days provided in the Commission's rule at 52 Pa. Code §3.291(c), and requested that the

Commission waive the provisions of the cited rule, alleging that the heavy workload of those assigned to these proceedings precluded a timely filing. For good cause shown, the Commission waives the time requirements of the rule and accepts the Trial Staff's filing.

THE COMMISSION'S EXCLUSION OF TMI-1 CAPITAL AND OPERATING COSTS

Respondents request that we reconsider our decision to exclude TMI-1 for rate base and expense purposes; their argument is three pronged. First, it is asserted that neither Section 1308(d) of the Public Utility Code, 66 Pa. C.S. §1308 (d), nor any other code provision establishes a standard or criterion that property must be "used and useful" in order to be included in rate base. Second, it is contended that the requirements of the United States Constitution, as enunciated by the United States Supreme Court in the *Hope, Permian Basin,* and *Memphis Light* decisions[1] require a "balancing" of consumer and investor interests and that the Commission's April 9, 1981 orders do not result in a "balancing" of those interests. Third, it is asserted that the Commission's order entered on August 4, 1976, in *Pa. P.U.C.* v. *Pennsylvania Gas and Water Company,* R.I.D. 209, was predicated upon investment and not the cost or value of used and useful property. The Respondents then urge the Commission to conclude that its decision in the latter case requires that the proposed rate increases be granted in their entirety.

The Office of Consumer Advocate contends that this subject "has been extensively litigated, briefed, argued and reargued

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[1]*FPC* v. *Hope Natural Gas Company,* 320 U.S. 591 (1944); *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968); *FPC* v. *Memphis Light, Gas & Water Division,* 411 U.S. 458 (1973).

since the fall of 1979," and refers the Commission to its main brief at these dockets, as well as the briefs submitted at docket I-79040308.

The Trial Staff's position is that the Respondents have not met their burden to demonstrate that the Commission's decision is clearly in error. Further, the Trial Staff observes that the "used and useful" standard is found in Section 1311 (relating to valuation of property of a public utility) of the Public Utility Code, 66 Pa. C.S. §1311, and relies on the recent decision of the New Jersey Supreme Court which affirmed the decision of the New Jersey Board of Public Utilities that TMI-1 is not used and useful in the public service.[2]

The instant petition calls upon the Commission to exercise its discretion under Section 703(g) of the Public Utility Code, 66 Pa. C.S. §703(g),[3] conferring upon the Commission the power to rescind prior orders after affording an opportunity to be heard. The Commission historically has granted relief upon reconsideration only in those rare situations in which it has been presented with new or after discovered material evidence, or with a new and novel argument which convinces it that its original decision is unjust, unreasonable, or contrary to law.

While we will not respond in detail to each and every argument made in the Respondents' petition, we have considered carefully each point and argument submitted. Not only are we convinced that our prior decision was in accord with law, we are satisfied that our decision is just and reasonable. The Respondents have argued vigorously against the "used and useful" standard

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[2]*In the Matter of the Petition of Jersey Central Power & Light Company*, April 8, 1981.

[3]*See also Abramson* v. *Pa. P.U.C.*, _____ Pa. _____, 414 A.2d 60 (1980).

enunciated in the Recommended Decision of the Administrative Law Judge. Even were we to agree that such standard were inappropriate, the ultimate or overriding criterion was stated by the Supreme Court in the *PG&W* case to be the establishment of "just and reasonable" rates pursuant to Section 1310 of the Public Utility Code, 66 Pa. C.S. §1301.[4] We again conclude that our orders entered April 9, 1981, comport with that standard, and we therefore decline to modify those orders.

THE COMMISSION'S DECISION WITH RESPECT TO RESERVE CAPACITY

Under the PJM and GPU power pool agreements each member is either charged or credited for reserve capacity depending upon the reserve capacity of each utility. In this proceeding the Respondents' claims regarding reserve capacity costs did not reflect the credits applicable to TMI-1 and TMI-2. In the case of Metropolitan Edison Company, the amount was $23,103,000. In the case of Pennsylvania Electric Company, the amount was $11,390,000.

The Office of Consumer Advocate proposed an adjustment to the claimed reserve capacity costs to reflect these credits. The Administrative Law Judge rejected these proposed adjustments.

In its exceptions the Office of Consumer Advocate urged that the adjustments be adopted or alternatively, if allowed, that normalized accounting be required in order that the credits would be available in the future at such time as the outages of TMI-1 and TMI-2 were reflected in the PJM reserve capacity calculation.

We adopted the latter position. Ordering Paragraphs No. 8 of each of our final Orders entered on April 9, 1981, provided that:

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[4] *Pa. P.U.C.* v. *PG&W*, _____ Pa. _____, 424 A.2d 1213, 1219 (1980).

Order of the Pennsylvania Public Utility Commission, entered July 27, 1981

> The (Metropolitan Edison, Pennsylvania Electric) Company shall engage in normalized accounting for reserve capacity expenses related to the TMI-1 and TMI-2 units in accordance with generally accepted accounting principals.

This provision was designed to implement our rejection of the adjustments proposed by the Office of Consumer Advocate, which adjustments would have reduced the reserve capacity expenses claimed by the Respondents, by the applicable credits related to the TMI-1 and TMI-2 units reflected in the Respondents' reserve capacity expenses.

Respondents' position on this subject was stated in their petition as follows:

> Respondents are troubled, however, by the requirements in the orders that Respondents utilize "normalization accounting" with respect to reserve capacity expense . . . without any clarification as to the amounts of such expenses to be normalized.

The Respondents agree that "to the extent" that the present outages give rise to future expense obligations, normalization is appropriate. However, stating that they are seeking to mitigate the future impact of the outages on reserve capacity obligations, Respondents urge that the normalization requirements contained in Ordering Paragraphs No. 8 either be eliminated or modified. More specifically, the Respondents have stated:

> So far as future ratemaking is concerned, Respondents made the unqualified commitment on the record that in future rate proceedings when any TMI unit is back in service and the facts about the impact, if any, of the present TMI outages upon future reserve capacity expenses are known, they "will make an appropriate corresponding normalization ad-

> justment to eliminate any possibility of any double recovery of reserve capacity expenses".
>
> * * *
>
> It is requested that the "normalization accounting" requirements of the orders either be eliminated or, in the alternative, be clarified and limited to such amounts as Respondents deem appropriate in the light of the best evidence as to the amounts of Respondents' future PJM installed capacity obligations.[5]

To the extent that either of these two proposals either envision or might result in a flow back to customers of some greater or lesser amount than is collected as an operating expense, the proposals are rejected. The commitment made by Respondents in their Brief (page 142) that they "will make an appropriate corresponding normalization adjustment to eliminate any possibility of double recovery of reserve capacity expenses," was made in a different context than it appears above, and might be read to have a different meaning. The meaning we attributed to the statement was that collections of expenses permitted in these proceedings were to be credited or flowed back on a dollar for dollar basis. We view this subject as one solely of timing, and we agreed with the Respondent's proposal only on that basis and understanding.

It was stated in our Orders that:

> [T]his expense collection will be credited against future expense incurrence where the TMI-1 and TMI-2 outages are reflected in the Respondent's reserve capacity expenses. . . .

The above quotation from Respondents' petition envisions a ratemaking adjustment at the time that a unit or units are back in service. To the extent that these two events might take place at

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[5]Petition pages 20-21.

different points in time, we shall not decide the timing of the credits to be made to expenses in this proceeding, but will leave such a decision for the future.

Another concern discussed by the Respondents regarding normalized accounting is that this requirement would "vitiate the financial benefit of those revenues." While the language of Ordering Paragraph No. 8 speaks of "normalized accounting" and "in accordance with generally accepted accounting principals," it was not intended to control the accounting by the Respondents for financial accounting purposes. What was intended is that the Respondents should maintain appropriate records of the collection of the allowed reserve capacity expenses in question on a current basis, and in the manner and detail which would be dictated by generally accepted accounting standards.

In accordance with the foregoing discussion and clarification, the requested modification of our Orders of April 9, 1981, is granted in part and denied in part.

MATHEMATICAL ERROR — EXCESSIVELY REDUCING PENELEC'S STORM DAMAGE EXPENSE CLAIM

The Respondents assert, and the Office of Consumer Advocate and the Trial Staff concur, that the Administrative Law Judge made a mathematical error when rejecting Pennsylvania Electric Company's storm damage expense claim, in reducing claimed operating expenses by $603,000, rather than the $60,000 of expenses claimed. We will correct this error by increasing the expense allowance by $543,000 which in turn increases operating revenues by $555,000; THEREFORE,

IT IS ORDERED:

1. That the Petition of Metropolitan Edison Company and Pennsylvania Electric Company for Reconsideration and Modifi-

cation of Orders Entered in these Dockets on April 9, 1981, is granted to the extent indicated herein and is otherwise denied.

2. That Pennsylvania Electric Company is authorized to file tariffs or tariff supplements designed to produce an additional $555,000 in total operating revenues, exclusive of revenues to be derived from the State Tax Adjustment Surcharge, based upon the year-end level of operations of the test year ending March 31, 1981.

3. That tariffs or tariff supplements may be filed upon less than statutory notice, and, pursuant to the provisions of 52 Pa. Code §3.321(b), the tariffs or tariff supplements may be filed to become effective upon one days notice.

4. That each tariff or tariff supplement will be accompanied by a proof of revenues for each rate schedule, reflecting the normalized level of operations at year-end of the test year ending March 31, 1981, in the format and detail as provided in Respondents' Exhibits C-4.

5. The Ordering Paragraph No. 8 of both Orders entered herein on April 9, 1981 is amended to read:

> "8. That (Metropolitan Edison; Pennsylvania Electric) Company shall maintain detailed records of the collection of the allowed reserve capacity expenses related to the TMI-1 and TMI-2 units (excluded reserve capacity credits) on a current basis and in the manner and detail required by generally accepted accounting practices."

6. That to the extent not specifically clarified or modified herein, our Orders entered herein on April 9, 1981, are affirmed.

BY THE COMMISSION
William P. Thierfelder
Secretary

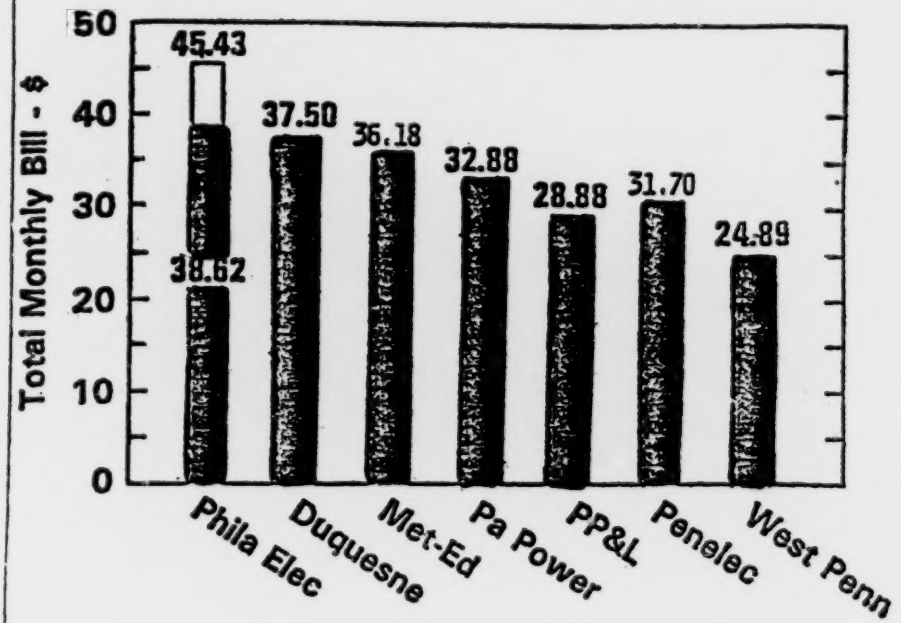
(SEAL)
ORDER ADOPTED: JULY 24, 1981
ORDER ENTERED: July 27, 1981

Appendices A and B of Appellants' Petition to Pennsylvania Public Utility Commission for Reconsideration of Order entered April 9, 1981

APPENDIX A

Typical Bill Comparisons, Penelec and Met-Ed Compared to other Pennsylvania Utilities

Residential No Water Heating 500 KWH/Month



■ Rates in effect in April 10, 1981.

□ If pending rate increase were granted in full

¢/Kwh							
■	7.7	7.5	7.2	6.6	5.8	6.3	5.0
□	9.1	-	-	-	-	-	-

METROPOLITAN EDISON COMPANY
PENNSYLVANIA ELECTRIC COMPANY

ANNUALIZED EFFECTS OF 1) PAPUC'S ORDERS, ENTERED 4/9/81, AND 2) MET-ED'S AND PENELEC'S REQUESTED RATE INCREASES PRO FORMA UPON ACTUAL RESULTS OF OPERATIONS FOR THE TWELVE MONTHS ENDED 3/31/81

	Metropolitan Edison Company Pro Forma For Annualized Effects			Pennsylvania Electric Company Pro Forma For Annualized Effects		
	Actual Results 12 Months Ended 3/31/81	PAPUC's Order Entered 4/9/81	Requested Rate Increase	Actual Results 12 Months Ended 3/31/81	PAPUC's Order Entered 4/9/81	Requested Rate Increase
Rate of Return on Common Equity at 3/31/81	(4.2)%	1.7%	5.9%	5.1%	10.9%	14.1%
Interest Coverage Ratio for 12 Months Ended 3/31/81(1)	0.7 x	1.8 x	2.5 x	1.9 x	2.9 x	3.3 x
Preferred Stock Dividend Coverage Ratio for 12 Months Ended 3/31/81(2)	0.8 x	1.2 x	1.4 x	1.3 x	1.7 x	1.9 x

(1) Met-Ed's and Penelec's debenture indentures require earnings available for the payment of fixed charges to cover such annualized fixed charges by a minimum of 2 times (2x) after the issuance of any new funded debt to permit such issuance.

(2) Met-Ed's and Penelec's charters require earnings available for fixed charges and preferred stock dividends to cover such annualized fixed charges and preferred stock dividends by a minimum of 1½ times (1½×) after issuance of any new preferred stock to permit such issuance.

Testimony of T. L. Carroll and J. G. Graham

Carroll-Graham direct 117

* * *

We then had some expressions of interest but, after analysis by various of the investors, the insurance companies and pension funds, the issue failed in the marketplace, it had to be withdrawn. That happened in August. It is now clear that Penelec has no access to any permanent capital market.

Q. In addition to filing a complaint with respect to the temporary rates Penelec has also recently filed a petition making various suggestions. Could you describe briefly what is represented in that petition?

A. (Graham) Yes, sir, this petition, which is essentially the same as that filed on behalf of Metropolitan Edison Company, attempts to respond to the suggestion in Judge Matuschak's October 16 order that an early disposition of the complaints filed against the temporary rates be implemented, and it gives suggestions with respect to the level of base rates, several other related matters that in our view is a basis for disposing of all of this, so that we might get on with the rate cases.

* * *

In The
SUPREME COURT OF PENNSYLVANIA
Nos. 31and 32 M.D.
Appeal Docket 1984

PENNSYLVANIA ELECTRIC COMPANY,
Appellant,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee,

OFFICE OF CONSUMER ADVOCATE, *et al.*
Intervenors.

METROPOLITAN EDISON COMPANY,
Appellant,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee,

OFFICE OF CONSUMER ADVOCATE, *et al.*
Intervenors.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Pennsylvania Electric Company and Metropolitan Edison Company, the appellants above named, hereby appeal to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of Pennsylvania, entered in this action on December 9. 1985.

This appeal is taken pursuant to 28 U.S.C. §1257(2).

March 3, 1986

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Supreme Court, U.S.
FILED
APR 9 1986
JOSEPH F. SPANIOL, JR.
CLERK

(2)

No. 85-1493

In the Supreme Court of the United States

October Term 1985

METROPOLITAN EDISON COMPANY,
Appellant
v.
PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee
OFFICE OF CONSUMER ADVOCATE et al.,
Intervenors

PENNSYLVANIA ELECTRIC COMPANY,
Appellant
v.
PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee
OFFICE OF CONSUMER ADVOCATE et al.,
Intervenors

On Appeal From the Supreme Court of Pennsylvania

MOTION OF APPELLEE OFFICE OF CONSUMER ADVOCATE TO DISMISS OR AFFIRM

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MOTION OF OFFICE OF CONSUMER ADVOCATE TO DISMISS APPEAL, OR, IN THE ALTERNATIVE, MOTION TO AFFIRM

Pursuant to Supreme Court Rule 16.1, the Office of Consumer Advocate (OCA) * hereby moves that this Court dismiss this appeal of Metropolitan Edison Company and Pennsylvania Electric Company, on the ground that the appeal does not present a substantial federal question. In the alternative, the OCA moves that this Court affirm the decision of the Supreme Court of Pennsylvania rendered below.

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* The Pennsylvania Office of Consumer Advocate, a party below, is an agency of the Commonwealth of Pennsylvania authorized to represent the interests of Pennsylvania utility consumers before the Pennsylvania Public Utility Commission and other state and federal agencies and courts which regulate the activities of Pennsylvania's public utilities. Pa. Stat. Ann. tit. 71, §309-1 *et seq.* (Purdon Supp. 1985). In the present proceeding, the OCA has represented the interests of the ratepayers of Metropolitan Edison Company and Pennsylvania Electric Company from the inception of this case in 1980 and throughout the administrative and appellate process.

COUNTERSTATEMENT OF THE CASE

On March 28, 1979, an accident occurred at the Three Mile Island nuclear generating station near Harrisburg, Pennsylvania. As noted by the Pennsylvania Supreme Court in its Opinion below, the accident was "the most serious in the history of nuclear power generating facilities in the United States," and resulted in the "near melt-down" of Three Mile Island Unit 2 (TMI-2). Appellants' Appendix at A2. TMI-2, which had entered commercial service just a few months prior to the accident, was severely damaged and remains out of service indefinitely at this time.

At the time of the accident at TMI-2, another reactor at Three Mile Island, TMI-1, had been shut down for refueling. TMI-1 had been in service since 1974, but following the accident, the Nuclear Regulatory Commission directed that TMI-1 remain out of operation until certain safety concerns regarding the restart of that reactor were fully resolved by that agency.

The present case arises from the ratemaking treatment accorded by the Pennsylvania Public Utility Commission (PUC or Commission) to the investment in Three Mile Island of two Pennsylvania utilities, Metropolitan Edison Company (Met-Ed) and Pennsylvania Electric Company (Penelec). Specifically at issue is the PUC's decision in 1981 which refused to allow Met-Ed and Penelec to charge their ratepayers a current return on their investment in TMI-1 while that unit remained out of service.*

* Met-Ed owns 50 percent of TMI 1 and 2, while Penelec owns 25 percent of both units. The remaining 25 percent is

It should be noted that the PUC did not remove the costs of TMI-1 from rates immediately after the accident at TMI-2. The costs of TMI-1 had been reflected in the rates of Met-Ed and Penelec for several years prior to the accident. In an Order dated June 15, 1979, the PUC removed the costs of the clearly useless TMI-2 from rates but allowed the utilities to continue to charge ratepayers for all costs associated with TMI-1. *Pa. PUC v. Metropolitan Edison Co.*, 29 PUR 4th 502 (1979). The basis for the PUC's ruling on TMI-1 was that:

> At this time it appears reasonably certain that TMI-1 will return to service. Witness Herman Dieckamp, president of GPU, testified that resumption of generation at TMI-1 could occur as early as August, 1979, and certainly no later than January 1, 1980.

Id. at 507.

Despite Mr. Dieckamp's certainty, however, January 1, 1980, came and went, but TMI-1 remained out of service. In fact, as noted by Appellants at page 8 of their Jurisdictional Statement, TMI-1 did not resume operation until October 3, 1985.

The full costs of TMI-1 continued to be reflected in the rates of Met-Ed and Penelec until May, 1980, at which time the Commission set temporary rates excluding certain TMI-1 costs due to the continued uncertainty of the return of that unit to utility service. The May, 1980 decision was

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owned by Jersey Central Power and Light Company (Jersey Central), which is located in New Jersey. All three of these utilities are subsidiaries of General Public Utilities Company (GPU), a public utility holding company registered under the Public Utility Holding Company Act of 1935.

reached after the plant had already been totally out of service for more than a year—a period during which ratepayers of Met-Ed and Penelec not only bore all the base rates costs of TMI-1, but also the costs of generating or purchasing higher cost replacement power to make up for the massive amounts of generation lost at both TMI units.

On July 29, 1980, Met-Ed and Penelec filed the rate increase requests which are the subject of the present appeal. Met-Ed requested a rate increase of $76.5 million, while Penelec requested $67.4 million. Both utilities sought to include the costs of TMI-1 in rates as part of their request. By Order entered April 9, 1981, as reaffirmed by an Order on Reconsideration on July 27, 1981, the PUC refused to grant the utilities' requests to charge ratepayers a return on the still inactive TMI Unit 1. Nevertheless, the PUC granted Met-Ed and Penelec rate increases of $51.8 million and $55.4 million respectively.

In denying the utilities a return on TMI-1, the PUC relied on the longstanding principle of Pennsylvania public utility law that ratepayers may only be required to pay a return on utility property which is "used and useful" in providing utility service. This principle is not peculiar to Pennsylvania law. Rather, as recently noted by Judge Starr in an Opinion of the United States Court of Appeals for the District of Columbia:

> For nearly a century the "used and useful" principle, enunciated by the Supreme Court in *Smyth v. Ames*, 169 U.S. 466, 18 S.Ct. 418, 42 L.Ed. 819 (1898), has stood as a bedrock principle of utility rate regulation. The principle is simple—it requires that costs associated with electric power plants be paid by the ratepayers who benefit from the plant.

Kentucky Utilities Co. v. FERC, 760 F.2d 1321, 1324 n. 4 (D.C. Cir. 1985).

Though removing certain costs of TMI-1 from rates, the PUC ordered a number of other adjustments which had the effect of increasing Met-Ed's and Penelec's rates substantially over their prior levels. First, the Commission allowed the Companies to charge rates which included two of the highest rates of return on equity that had ever been permitted for Pennsylvania public utilities at that time—a 17 percent return for Met-Ed and a 16.5 percent return for Penelec. Second, the PUC permitted Met-Ed and Penelec to set their rates to exclude certain reserve capacity credits which, if recognized, would have reduced the rates of Met-Ed and Penelec by $23.1 million and $11.4 million respectively.* Third, the PUC did not remove *all* the costs of TMI-1 from rates, but instead allowed $11 million of TMI-1 related expenses for Met-Ed and $5.4 million for Penelec. Fourth, the PUC permitted the utilities to cease accruing depreciation for TMI-1 on their books. This had the effect of holding the value of TMI-1 constant so as to permit the full future recovery of the remaining TMI-1 investment

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* Reserve capacity credits are charges which Met-Ed and Penelec would either receive or pay under the regional Pennsylvania-New Jersey-Maryland (PJM) power pool agreement. In the rate decision under appeal here, the Commission allowed Met-Ed and Penelec to set rates on the basis of a "normalized" level of reserve capacity expenses which were $23.1 million and $11.4 million higher than the amounts which actually were incurred during the time period examined for the setting of rates. As stated by the Commonwealth Court, by normalizing these expense credits, the Commission "allowed, in effect, an interest-free loan by customers to the utilities." Appellants' Appendix at A-13.

from ratepayers when and if the plant returned to service. Finally, the PUC permitted the utilities to continue to charge ratepayers the full cost of replacement power for TMI-1, a cost which, in fact, exceeded the economic "benefit" which ratepayers received by having the return on TMI-1 removed from base rates.

Met-Ed and Penelec sought review of the Commission Orders in the Pennsylvania Commonwealth Court. That Court affirmed the PUC Orders, holding that "the Commission's exclusion of capital costs and operating expenses of TMI-1 was proper" and that the PUC Orders "properly balanced investor and consumer interests." Appellants' Appendix at A20, A22.

Met-Ed and Penelec then sought review of the Commonwealth Court Order in the Pennsylvania Supreme Court. On December 9, 1985, the Supreme Court affirmed the Commonwealth Court Order. Specifically, the Court upheld the denial of a return on TMI-1 as a proper application of the used and useful principle and rejected the utilities' arguments that the application of that principle in this case violated constitutionally protected investor interests which the Appellants alleged were established in the United States Supreme Court decision in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

Before addressing the Appellants' substantive arguments here, one other factual circumstance should be noted. That is, while the above-noted proceedings were making their way through the Pennsylvania regulatory and appellate process, a parallel proceeding was occurring at a somewhat quicker pace in New Jersey with respect to the TMI-1 investment of Jersey Central. In New Jersey, as in Pennsylvania, the governing regulatory agency and appel-

late court found that TMI-1 was properly excluded from rates under the long-established used and useful principle. The New Jersey court also rejected the utility's argument that the New Jersey Board of Public Utilities had violated the rights of Jersey Central's investors as set forth in the *Hope* case.

On March 5, 1984, Jersey Central appealed that decision to the United States Supreme Court on the basis of virtually the same facts and the same allegedly constitutional issues raised in Met-Ed and Penelec's Jurisdictional Statement in the present case. *Jersey Central Power & Light Co. v. Board of Public Utilities,* October Term 1983, No. 83-1478. On April 23, 1984, this Court dismissed Jersey Central's appeal for want of a substantial federal question. *Jersey Central Power & Light Co. v. Board of Public Utilities,* 466 U.S. 947 (1984).

Appellants Met-Ed and Penelec filed the Jurisdictional Statement in the present case on March 7, 1986. The Office of Consumer Advocate, a party to the case below, received the Appellants' Jurisdictional Statement on March 10, 1986, and is filing this Motion on behalf of Met-Ed and Penelec ratepayers to dismiss the appeal or, in the alternative, to affirm the decision of the Pennsylvania Supreme Court below.

ARGUMENT

I. The Precise Issue in This Case, Involving the Same Electric Generating Plant and the Same Legal Argument, Was Recently Dismissed by This Court for Want of a Substantial Federal Question

As noted in the above Counterstatement of the Case, the Appellants in this proceeding own only 75 percent of the Three Mile Island Unit 1 nuclear plant, which is the source of the Pennsylvania public utility ratemaking dispute at issue here.

The remaining 25 percent of TMI-1 is owned by the Jersey Central Power and Light Company (Jersey Central), the New Jersey-based utility which, along with Met-Ed and Penelec, comprise the three operating subsidiaries of the General Public Utilities Company (GPU), a public utility holding company.

In New Jersey, as in Pennsylvania, the utility was unsuccessful in convincing the governing regulatory agency to permit the company to continue charging ratepayers for the dormant TMI-1 nuclear power plant. Jersey Central was also unsuccessful in persuading the New Jersey appellate courts that the agency's treatment of its rate request violated certain constitutionally protected investor rights which were purportedly set forth by the United States Supreme Court in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

Jersey Central did not stop its quest for rate relief at the state court level, however. Rather, in an appeal docketed by this Court at No. 83-1478, the utility sought to have the New Jersey court decision overturned by the United States Supreme Court. *Jersey Central Power & Light Co. v. Board of Public Utilities,* October Term 1983, No. 83-1478. In its Jurisdictional Statement filed with this Honorable Court on March 5, 1984, Jersey Central presented the following questions:

> 1. Was the Court below correct in holding that the three investor-interest components of the criteria for determining whether electric utility rates are "just and reasonable" as specified by this Court in *Federal Power Commission v. Hope Natural Gas Company,* 320 U.S. 591, 603 (1944) "are not of constitutional dimension", even though rates which would satisfy such investor-interest criteria would not exploit customers?
>
> 2. Are ratemaking determinations which fail to assess their consequences to customers and investors violative of the due process requirements of the Fifth and Fourteenth amendments by reason of being arbitrary and capricious and preclusive of meaningful judicial review?

Jurisdictional Statement in *Jersey Central Power & Light Co. v. Board of Public Utilities,* October Term 1983, No. 83-1478, p. i.

Motions to dismiss Jersey Central's appeal or, in the alternative, affirm the the opinion of the New Jersey court below, were filed by the New Jersey Board of Public Utili-

ties and the Department of the Public Advocate (the counterparts of the PUC and OCA in the present proceeding).

On April 23, 1984, this Honorable Court dismissed the appeal of Jersey Central for want of a substantial question. *Jersey Central Power & Light Co. v. Board of Public Utilities,* 466 U.S. 947 (1984).

In the present proceeding, Jersey Central's Pennsylvania sister utilities, Met-Ed and Penelec, have presented the following question:

> Was the Court below correct in holding that the investor-interest components of the criteria for determining whether electric utility rates are "just and reasonable", as specified by this Court, in *Federal Power Commission v. Hope Natural Gas Company,* 320 U.S. 591, 603 (1944) and its progeny, are not of "constitutional dimension"?

Jurisdictional Statement at i.

The question presented in this appeal by GPU's Pennsylvania subsidiaries is nearly identical to the first question presented in the appeal brought by GPU's New Jersey subsidiary which was already dismissed by this Court. Further, the OCA submits that a review of the factual background and legal arguments raised by the Appellants in these two Jurisdictional Statements reveals that these cases are practically indistinguishable. The present appeal therefore simply represents a second attempt by essentially the same party to present the same issue which this Court already has found does not raise a substantial federal question.

As in the case of the virtually identical appeal of Jersey Central, the present appeal raises no substantial

federal question. In light of this Court's dismissal of the prior appeal of Jersey Central, as well as for the reasons set forth below, the OCA respectfully submits that the present appeal should be summarily dismissed as well.

II. The Appellants' Constitutional Challenge to the Pennsylvania Supreme Court Order Is Wholly Without Merit

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A. The Appellants' argument is not supported by the decision of this Court in FPC v. Hope Natural Gas.

The Appellants' entire argument before this Court rests on a complete misreading of Justice Douglas' opinion for the Court in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

In discussing the proper balancing of investor and ratepayer interests under the Natural Gas Act, the *Hope* opinion recognized the investor's "legitimate concern with the financial integrity of the company." 320 U.S. at 603. The Court *prefaced* that remark, however, by quoting the statement in its earlier opinion in *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 590 (1942), that "regulation does not insure that the business shall produce net revenues." 320 U.S. at 603. Because the appeal in *Hope* concerned only whether the *investor* interests had been adequately considered, and because the Court concluded that the "end result" in that case could not be condemned "as unjust and unreasonable *from the investor or company viewpoint*," *id.* (emphasis added), it was not necessary for the Court to set forth in detail the countervailing ratepayer interests which also must be considered. The Court thus noted that

"[t]he conditions under which more or less might be allowed are not important here." *Id.*

Thus, in writing for the Court in *Hope*, Justice Douglas recognized that:

> *From the investor or company point of view* it is *important* that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock.

Id. (Emphasis added.)

What is "important" to investors is not necessarily mandated by the Constitution, however, as evidenced by the language both before and after the enumeration of investor interests in the *Hope* opinion cited above.

The Court in *Hope* did not rule that the satisfaction of the investor interests enumerated therein was either statutorily or constitutionally mandated. Rather, the Court recognized that regulation might not result in any net revenues whatsoever. The Court also recognized that, while investor interests were certainly satisfied in that case, there might be conditions under which "more or less might be allowed." Because the "end result" in the *Hope* case clearly met the investors' needs, the Court held that those investors could not complain on appeal with respect to the particular ratemaking methodology which had been used by the Federal Power Commission in reaching that result. As stated by Justice Douglas:

> If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.

FPC v. Hope Natural Gas Co., 320 U.S. at 602.

The decision in *Hope* thus put an end to an era of judicial intervention in ratemaking decisions in which the courts, including the lower Court in the *Hope* case, had ruled that, as a matter of constitutional right, the "fair value" of the property on which a utility's rates were set had to include some measure of present value or reproduction cost, rather than be based upon the original or historical cost of the property.

The Court thus essentially adopted the view of the concurring opinion of Justice Douglas (the author of the *Hope* opinion), Justice Black and Justice Murphy in *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 607 (1942), that:

> Irrespective of what the return may be on "fair value," if the rate permits the company to operate successfully and to attract capital all questions as to "just and reasonable" are at an end *so far as the investor interest is concerned.*

(Emphasis added.)

In that concurrence, Justices Douglas, Black, and Murphy specifically cited the "havoc raised by insistence on reproduction cost" and noted that "the 'fair value' rule has proved to be unworkable by reason of the time required to make the valuations, the heavy expense involved, and the unreliability of the results obtained." 315 U.S. at 605. (Footnote omitted.)

The thrust of the *Hope Natural Gas* decision, therefore, was to limit the role of the courts in examining the minutiae of regulatory rate decisions and, particularly, to insure that the courts remained out of the business of de-

termining how the value of utility property in rate base must be calculated.

That the *Hope* decision was intended to serve as a basis for judicial restraint in the review of expert ratemaking decisions and *not* as a source of newly created constitutional rights for utility investors was made abundantly clear in a unanimous Supreme Court Opinion issued in 1945, just one year after the *Hope* case was decided. *Market Street Railway Co. v. Railroad Commission*, 324 U.S. 548 (1945).

In *Market Street Railway*, a financially distressed street railway company argued that the rate it had been granted was "confiscatory by the tests of *Federal Power Commission v. Hope Natural Gas Co.*," because it did not insure the financial integrity of the enterprise. *Id.* at 566. In the Opinion by Justice Jackson, the Court responded:

> It was noted in the *Hope Natural Gas* case that regulation does not assure that the regulated business make a profit. 320 U.S. at 603; see *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 590. *All that was held* was that a company could not complain if the return which was allowed made it possible for the company to operate successfully. There was no suggestion that less might not be allowed when the amount allowed was all that the company could earn.

Id. (Emphasis added.)

The Court in *Market Street Railway* thus confirmed that *Hope* did not alter the longstanding principles established in the 1896 Opinion of the senior Justice Harlin in

Covington & Lexington Turnpike Road Co. v. Sandford, 164 U.S. 578 (1896). There the Court had stated:

> It cannot be said that a corporation is entitled, as of right, and without reference to the interest of the public, to realize a given per cent upon its capital stock. When the question arises whether the legislature has exceeded its constitutional power in prescribing rates to be charged by a corporation controlling a public highway, stockholders are not the only persons whose rights or interests are to be considered. The rights of the public are not to be ignored. It is alleged here that the rates prescribed are unreasonable and unjust to the company and its stockholders. But that involves an inquiry as to what is reasonable and just for the public. If the establishing of new lines of transportation should cause a diminution in the number of those who need to use a turnpike road, and, consequently, a diminution in the tolls collected, that is not, in itself, a sufficient reason why the corporation, operating the road, should be allowed to maintain rates that would be unjust to those who must or do use its property. *The public cannot properly be subject to unreasonable rates in order simply that stockholders may earn dividends.*

Id. at 596. (Emphasis added.)

This principle was subsequently reaffirmed by the junior Justice Harlan, writing for the Court in the *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968). There, after reiterating the investor interests identified in *Hope*, the Court noted that, while these criteria "remain pertinent," they "scarcely exhaust the relevant considerations." *Id.* at 791. Rather, Justice Harlan wrote:

> The Commission cannot confine its inquiries either to the computation of costs of service or to conjectures about the prospective responses of the capital market; it is instead obliged at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection by Congress. Accordingly, the "end result" of the Commission's orders must be measured as much by the success with which they protect those interests as by the effectiveness with which they "maintain credit . . . and . . . attract capital."

Id. (Footnote omitted.)

As will be set forth more fully in the next section of this argument, the OCA submits that one of the other "relevant considerations" in setting just and reasonable rates is the need to protect ratepayers from being forced to pay not only for the cost of providing them with utility service, but also to pay a return on property which is owned by a utility but which is not used and useful in providing utility service. That is, while investors have an interest in the financial well-being of the utility company, the extent to which that interest must be satisfied by *ratepayers* is equal only to the extent to which the investments provide utility service to those ratepayers.

The OCA submits that none of the cases cited by the Appellants directly support their contention that the satisfaction of the investor interests set forth in *Hope* is constitutionally mandated.* Rather, as stated by the Pennsyl-

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* Appellants characterize a recently vacated panel opinion of the United States Court of Appeals for the District of Columbia as "essentially adopting the views here expressed." Jurisdictional Statement at 12; *Jersey Central Power & Light Co. v. FERC*,

vania Supreme Court in the Opinion below, the investor interests enumerated in *Hope* are "among the factors to be taken into account in the balancing of interests process," but are not "of constitutional dimension." Appellants' Appendix at A11.

Appellants may only succeed in this appeal if they can demonstrate that the Pennsylvania Supreme Court decision —which, as will be shown below, was clearly correct as a matter of Pennsylvania public utility law—violated their federal constitutionally protected rights. The Appellants' only argument that such a violation occurred is based on a strained interpretation of this Court's *Hope* decision which was flatly and unanimously rejected by this Court in the *Market Street Railway* case just one year after the *Hope* decision was rendered.

It is untenable to suggest that the principles of judicial restraint set forth by Justice Douglas in *Hope* were intended to provide a federal constitutionally guaranteed

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768 F.2d 1500 (D.C. Cir. 1985), *vacated for rehearing en banc*, 776 F.2d 364 (D.C. Cir. 1985). With respect to this decision, the OCA would note first that it has been vacated and is, therefore, of no precedential significance. Second, the OCA would point out that the utility in that case—Jersey Central—alleged that it had been denied a hearing by the Federal Energy Regulatory Commission (FERC) on the issue of whether FERC's Order denying a return on the abandoned Forked River generating plant violated the "end result" test set forth in the *Hope* opinion. The Panel majority found that Jersey Central should be granted a "full evidentiary hearing" on the matter and would have remanded the case to FERC. 768 F.2d at 1501. *See also*, concurring opinion of Judge Ginsburg, 768 F.2d at 1505. By contrast, in the present case, there is no question that Met-Ed and Penelec were given a full hearing and were accorded the full panoply of due process rights. *See* Jurisdictional Statement at 9-10.

right of public utility investors to override longstanding principles of state public utility law, whenever the application of those principles places the financial interest of investors in jeopardy. If, as noted in the *Hope* decision, "regulation does not insure that the business shall produce net revenues," 320 U.S. at 603 *(quoting FPC v. Natural Gas Pipeline,* 315 U.S. at 590), it is difficult at best to see how Met-Ed and Penelec can have a *constitutional* right to the particular level of net revenues that it has demanded in this case. The *Hope* decision does not mandate such a result and the Pennsylvania Supreme Court was correct in rejecting that view.

B. The Pennsylvania Supreme Court's reliance on the "used and useful" principle was a proper application of State Public Utility Law and was not violative of the utilities' constitutional rights.

As in each of the numerous rate cases that come before the Pennsylvania Public Utility Commission each year, the ultimate issue faced by the Commission in the case below was: what level of rates would be "just and reasonable" under the terms of the Pennsylvania Public Utility Code. 66 Pa. Cons. Stat. Ann. §1301 *et seq.* (Purdon 1979).

The ratemaking process that goes into this ultimate determination has been described by the Pennsylvania Commonwealth Court as requiring four basic determinations:

> 1. The company's *gross utility revenues* under the rate structure examined.

2. The *operating expenses* including all taxes appropriately incurred to produce gross revenues.

3. The *rate base,* which is all property which actually provides the service for which rates are charged and represents the base on which a return should be earned.

4. The *rate of return,* a percentage figure applied to the rate base which yields the return to which investors in the utility are reasonably entitled.

Bell Telephone Co. of Pennsylvania v. Pa. PUC, 47 Pa. Commonwealth Ct. 614, 618-619, 408 A.2d 917, 920-21 (1979). (Emphasis in original.)

In the present case, the primary controversy concerned the "rate base" component of rates and specifically whether the utilities' investment in the dormant TMI-1 nuclear plant should be included in the rate base on which a return should be allowed.

In making and reviewing that determination, the PUC, Commonwealth Court and Pennsylvania Supreme Court each placed primary reliance on the long-established principle of public utility law that a utility is only entitled to earn a return on property which is "used and useful" in the public service.

As noted in the above Counterstatement of the Case, the used and useful principle is not peculiar to Pennsylvania law. Rather, the principle has been applied by state and federal regulatory agencies throughout the Nation and, as recently stated by the United States Court of Appeals for the District of Columbia, "has stood as a bedrock principle of utility rate regulation" for "nearly a century." *Ken-*

tucky Utilities Co. v. FERC, 760 F.2d 1321, 1324 n. 4 (D.C. Cir. 1985).

The used and useful principle, though not the phrase itself, is generally traced back to this Court's Opinion in *Smyth v. Ames*, 169 U.S. 466 (1898). There, Justice Harlan wrote:

> We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public.

Id. at 546.

The constitutional underpinnings of the used and useful principle were subsequently set forth most clearly in *Denver Union Stock Yard Co. v. United States*, 304 U.S. 470, 475 (1938), where this Court stated:

> As of right safeguarded by the due process clause of the Fifth Amendment, appellant is entitled to rates, not *per se* excessive and extortionate, sufficient to yield a reasonable rate of return upon the value of property used, at the time it is being used, to render the services. *But it is not entitled to have included any property not used and useful for that purpose.*

(Citations omitted; emphasis added.)

This fundamental holding of the *Denver Union Stock Yard* case was based on an unbroken series of Supreme Court decisions which addressed this issue, starting with *Smyth v. Ames*, supra, 169 U.S. at 546-47, and continuing through such cases as *San Diego Land and Town Co. v. National City*, 174 U.S. 739, 757-758 (1899); *San Diego*

Land and Town Co. v. Jasper, 189 U.S. 439, 446-467 (1903); *Willcox v. Consolidated Gas Co.,* 212 U.S. 19, 41 (1909); *Minnesota Rate Cases,* 230 U.S. 352, 434, 454 (1913); *Los Angeles Gas & Electric Co. v. Railroad Commission,* 289 U.S. 287, 305-06, 311, 316-317 (1933); *Columbus Gas & Fuel Co. v. Public Utility Commission,* 292 U.S. 398, 406-407 (1934), and *St. Joseph Stock Yards Co. v. United States,* 11 F. Supp. 322, 329 (W.D. Mo. 1935), *aff'd,* 298 U.S. 38 (1936).

Nor is the used and useful principle a mere relic of the past. As noted in another recent opinion of the United States Court of Appeals for the District of Columbia:

> Although methods for determining values of rate base items have evolved since *Smyth v. Ames,* the precept endures that an item may be included in a rate base only when it is "used and useful" in providing service. In other words, current rate payers should bear only legitimate costs of providing service to them.

Natural Gas Pipeline Co. v. FERC, 765 F.2d 1155, 1157 (D.C. Cir. 1985), *cert. denied,* 106 S.Ct. 794 (1986), *quoting Tennessee Gas Pipeline Co. v. FERC,* 606 F.2d 1094, 1109 (D.C. Cir. 1979), *cert. denied,* 445 U.S. 920 and 447 U.S. 922 (1980).

The OCA submits that it is not without reason that the used and useful standard has continued to stand as a "bedrock principle" of rate regulation. Under whatever name it is given, the principle that ratepayers may only be required to pay a return on utility investment which is properly dedicated to the provision of utility service is fundamental to a rational ratemaking methodology.

Argument

Substantial discretion can and has been applied by regulatory agencies in deciding what constitutes used and useful property; how that property should be valued; and what rate of return should be allowed on such property. However, without some guiding principle to determine what investments of a utility should be included in the rate-making determination, a fair and meaningful balancing of consumer and investor interests would not be possible.

The used and useful principle permits a regulatory agency to differentiate between those investments made by a utility which serve ratepayers, and therefore are entitled to a return from those ratepayers, and investments which do not provide such service, and therefore are not the proper responsibility of ratepayers. As recognized by this Court in *Denver Union Stock Yard*, supra, investors have no right, constitutional or otherwise, to demand a return from ratepayers on investments which do not serve those ratepayers. Similarly, regulation should impose no obligation on ratepayers, who typically have no choice as to where to purchase monopoly utility services, to support investments of a utility which do not serve those ratepayers.

Contrary to the view of Appellants as set forth in their Jurisdictional Statement, the used and useful principle is not just a "catchy phrase" which has been "glibly employed" by this Court and others in deciding public utility rate cases. Jurisdictional Statement at 12 and 13. Rather, as many courts have recognized over the last 90 years, this principle represents an equitable and rational standard under which ratepayers are protected from unduly high rates while investors are assured an opportunity to earn a fair return on their investment which is utilized in providing a public service.

Moreover, there is nothing in the *Hope* decision which indicates that this Court intended the used and useful principle to be displaced by a new constitutional standard which states that utility investors must be provided with satisfactory returns on all investments whether or not those investments are utilized in the actual provision of utility service. As stated by the Pennsylvania Supreme Court in its Opinion below:

> The "used and useful" concept came into existence long before the *Hope* decision was rendered, and it is not generally regarded as having been overridden by that decision.

Appellants' Appendix at A9.

Indeed, the OCA submits that the apparently disparate themes of *Hope*—that legitimate investor interests should be considered, but that regulation does not assure a profit—can best be reconciled by recognizing that the *Hope* opinion did not, and was not intended to, overturn the fundamental principle that a utility has *no* right to demand a return from ratepayers on property which is not of service to those ratepayers. Again, the United States Supreme Court's nearly contemporaneous review of *Hope* in *Market Street Railway* is instructive.

In *Market Street Railway,* the Supreme Court upheld a six-cent fare, which allowed a failing street railway company a six percent return on a rate base of $7,950,000. 324 U.S. at 557. This rate base valuation, which was equal to the price at which the company had offered to sell its operating properties to the municipality which it served, was attacked by the utility as confiscatory, *id.* at 564, but was upheld by this Court even though the book value of the

company's property was $41,768,505 and a valuation study of the properties' "historical reproduction cost" indicated a current value of $25,343,543. *Id.* Indeed, the Company argued that the valuation of its property

> did not consider reproduction cost, historical cost, prudent investment, or capitalization bases, on any of which under conventional accounting the six-cent fare would produce *no return* on its property and would force a substantial operating deficit upon the Company.

Id. at 553-54. (Emphasis added.)

As noted above, the Court rejected the Company's contention that the rate order was "confiscatory" under the *Hope* case. Rather, Justice Jackson wrote in the Court's unanimous opinion that:

> Without analyzing rate cases in detail, it may be safely generalized that the due process clause never has been held by this Court to require a commission to fix rates on the present reproduction value of something no one would presently want to reproduce, or on the historic valuation of a property whose history and current financial statements showed the value no longer to exist, or on an investment after it has vanished, even if once prudently made, or to maintain the credit of a concern whose securities already are impaired. The due process clause has been applied to prevent governmental destruction of existing economic values. It has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces.

Id. at 567.

The above analysis is particularly relevant here, since it was technological and economic forces which rendered Met-Ed's and Penelec's investment in the Three Mile Island units either temporarily or permanently useless. The ratemaking orders of the Pennsylvania PUC were not the cause of the utilities' financial problems, nor should they be required to be the total solution.

As discussed more fully below, the PUC, though denying a return on TMI-1, addressed the interests of investors by granting Met-Ed and Penelec a generous return on the Companies' used and useful property and making a number of other favorable ratemaking adjustments which had the effect of raising the utilities' rates substantially.

While the OCA submits that a much lower rate increase would have been quite appropriate and constitutionally defensible, there can be no question that the Appellants have no *constitutional* entitlement to even greater rate increases than the ones they received in this case.

As noted in the preceding section of this Argument, this Court found in the *Hope* case that the investor interests in the utility in question had been more than adequately satisfied and therefore the conditions "under which more or less might be allowed" were not "important" to that decision. The OCA submits that one of the conditions under which "less might be allowed," is a case such as this, where a very substantial portion of the utility's investment is not used and useful to the ratepaying public and therefore not entitled to earn a return from those ratepayers.

The application of the used and useful principle in this case was consistent with applicable state law and with the constitutional requirements set forth by this Court in

Denver Union Stock Yard Co. v. United States, 304 U.S. 470, 475 (1938). As correctly found by the Pennsylvania Supreme Court, there is nothing in *FPC v. Hope Natural Gas Co.* or any other Opinion of this Court which requires —as a matter of constitutional law—that this principle be overridden in this case.

C. The PUC and the Pennsylvania Courts adequately addressed the interests of investors in this proceeding.

At page 4 of their Jurisdictional Statement Appellants contend that:

> the PUC order was constitutionally invalid because the PUC had not balanced—and did not purport to balance—the consumer and investor interests in the manner required by *Hope* and its progeny.

The above statement, as amplified and repeated throughout the Jurisdictional Statement, misstates both the holding in the *Hope* case and the actions taken by the PUC which have enabled Met-Ed and Penelec to survive the TMI catastrophe intact.

As explained in the above Counterstatement of the Case, after the March 28, 1979, accident at Three Mile Island, the Commission addressed the Appellants' various ratemaking claims, including their requests regarding TMI-1, in a series of Orders. These Orders addressed some of the most difficult issues ever presented to the Pennsylvania Public Utility Commission—issues which, contrary to the representations of the Appellants, were not dismissed in a cavalier manner.

Thus, for example, in the May 23, 1980, Order which first removed TMI-1 costs from rates, the Commission wrote:

> The current proceedings have presented exceedingly difficult issues for this Commission to resolve. The Commission has had to balance the need to explore and carefully examine Met Ed's continuing, long-term viability against the urgency to act promptly to avoid being overtaken by events. In addition, the Commission has had to resolve the competing concerns of creditors who want assurance of earnings and ratepayers who want equity in allocating the costs associated with the Three Mile Island accident (and who see an inequitable duplication in paying the costs of TMI-1 and the costs of TMI-1 replacement power); and of Respondents who would emphasize their financial needs and other parties seeking a determination based on other economic, social and political principles.
>
> * * *
>
> The Commission will provide Met Ed the means of financial rehabilitation. However, we will write no blank checks on its ratepayers. We find that TMI-1 is no longer used and useful and that the base rates of both Met-Ed and Penelec should be reduced. This order, with its provisions for a fully current recovery of energy costs and an accelerated amortization of deferred energy costs provides an adequate framework for Met Ed's recovery. Respondent must convince its bank creditors that it has the will and the ability to rehabilitate itself.

Pa. PUC v. Metropolitan Edison Co. and Pennsylvania Electric Co., 37 PUR 4th 77, 80-81 (1980).

Similarly, in the subsequent rate case which is the subject of the present appeal, the presiding Administrative Law Judge, whose Recommended Decision was substantially adopted by the Commission, noted:

> This rate case is unique. It is unique because of TMI. It is in this context that we must resolve this rate proceeding. There are no precedents to sharply define our ratemaking responsibility under such extraordinary circumstances. We must fashion our own course. In doing so, we may find it necessary, within the discretion legally reposed in us, to depart somewhat from traditional ratemaking procedures; we must weigh and examine current procedures and policies in the light of unprecedented conditions.
>
> Met Ed, principally because of the accident at TMI-2, and the subsequent suspension of TMI-1, is in a difficult financial condition. It is that condition which permeates this rate case proceeding.
>
> It must be clearly understood that it is not our responsibility, privilege or purpose to bail out Met Ed from all its financial problems with ratepayers' money. Truly, Met Ed's financial burdens cannot be totally solved through the ratemaking process.

Pa. PUC v. Metropolitan Edison Co., No. R-80051196, ALJ Recommended Decision, Slip op. at 6 (March 20, 1981).

It was in light of the competing concerns of the utilities' investors and ratepayers in this case that the Commission ultimately granted Met-Ed $51.8 million, or 68%, of the $76.5 million rate increase it originally requested, while

granting Penelec $55.4 million, or 82%, of its $67.4 million request.

In reviewing these Commission rate orders, the Commonwealth Court rejected the utilities' contention that the Commission did not balance the interests of investors and ratepayers as follows:

> We find that the Commission did not abuse its discretion in finding that TMI-1 was not used or useful and thus in excluding its capital and operating costs from the rate bases. The actions of the Commission do reflect a balancing of investor and consumer interests as prescribed by the Supreme Court in *Pennsylvania Gas and Water Co.* The allowed increase for Penelec included $5.5 million for TMI-1 related costs and reflected a 16.5% rate of return on common equity capital. The allowed increase for Met Ed included $11 million for TMI-1 related costs and reflected a 17% rate of return on common equity capital. This is the highest rate ever allowed a Pennsylvania utility. Further, TMI-1 was out of service for a full 14 months before its capital costs and operating expenses were excluded from the companies' rate bases. Finally, the Commission normalized the reserve capacity expense credits, discussed *infra*, which allowed the reserve capacity expense to be shown in the test year as $11.4 million higher than the actual reserve capacity expense. For these reasons, we find the Commission properly balanced investor and consumer interests in excluding TMI-1 capital costs and operating expenses from the companies' rate bases.

Appellants' Appendix at A21-A22. (Footnotes omitted.)

Finally, the Pennsylvania Supreme Court affirmed the Commonwealth Court Order and specifically stated that the PUC decisions "reflect a balancing of consumer and investor interests." Appellants' Appendix at A11, note 1.

In short, it is not the refusal of the Pennsylvania Commission and courts to balance the interests of investors and ratepayers which gives rise to the present appeal. Rather, the alleged injustice lies in the failure of these bodies to "balance" these interests in the manner sought by the Appellants—i.e. by granting the utilities every dollar of ratepayer money which they requested.

As shown above, however, the Commission's refusal to accede to all of the utilities' rate demands certainly does not amount to an unconstitutional taking of the utilities' property. Nor were the Companies' constitutional rights violated in any other way. The PUC considered and carefully addressed the interests of the utilities' investors throughout this extraordinarily difficult ratemaking process. The utilities' argument that their investors' interests were not adequately considered is totally without merit.

D. The Appellants' arguments regarding the "exploitation" of ratepayers are legally incorrect and are not properly applied by the Appellants in this case.

In their Jurisdictional Statement, Appellants assert that the Pennsylvania Supreme Court "misstated" the issue before it when it characterized the utilities' argument as being that *Hope* provided investors with a guarantee of financial integrity "irrespective of countervailing consumer

interests." Jurisdictional Statement at 4-5. Appellants contend that their argument actually has been that *Hope* requires rates "which promote the financial integrity of utilities as measured in the manner directed by *Hope*, *if—but only if*—such rates would not exploit customers." *Id.* at 5. (Emphasis in the original.) Though Appellants allude to this statement of their argument several times throughout the Jurisdictional Statement, *id.* at 5, 6, 10, 16, they never define what an "exploitative" rate is, nor do they provide any authority for the position that investor interests must override established ratemaking principles until this undefined border of exploitation is crossed.

In response to this argument, it should first be noted that this interpretation of *Hope* is directly contradicted by this Court's own interpretation of *Hope* in *Market Street Railway*, supra. In that unanimous opinion issued one year after the *Hope* decision, the Court upheld a fare *reduction* from seven cents to six cents for a failing street railway company, in spite of the Company's contention that the setting of such a fare was:

> confiscatory by the tests of *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 605, from which [the company] claims to be entitled to a return "sufficient to assure confidence in the financial integrity, to attract capital, and to compensate its investors for the risk assumed."

324 U.S. at 566.

Nothing in the *Market Street Railway* case suggests that the previous seven-cent fare or any other fare higher than six cents would have been deemed "exploitative" or that "but for" such a threat of exploitation, the Company's

Hope-related arguments would have been accepted. Rather, the Court simply rejected the company's totally fallacious reading of the *Hope* opinion and reiterated that: "All that was held [in *Hope*] was that a company could not complain if the return which was allowed made it possible for the company to operate successfully." *Id.*

While the Appellants in the present case never specify what would constitute an "exploitative" rate, they do state at page 10 of the Jurisdictional Statement that:

> Met-Ed and Penelec presented unchallenged evidence that, even if their requested rate increases were granted in full, their rates would be in line with those of customers of other utilities in Pennsylvania and neighboring area.

If, by this statement, Appellants mean to imply that their ratepayers would not be "exploited" until their rates were the highest in Pennsylvania or the Northeast region, then they are mistaken.

The idea that the justness and reasonableness of rates of one utility can be judged by their relationship to rates of other utilities was dismissed long ago by this Court. Like several of the Appellants' arguments in this case, this issue was addressed quite adequately by Justice Harlan in his 1896 opinion in *Covington & Lexington Turnpike Road Co. v. Sanford*, 164 U.S. 578 (1896). As Justice Harlan noted regarding the rates of the public highway in that case:

> If a corporation cannot maintain such a highway and earn dividends for stockholders, it is a misfortune for it and them which the Constitution does not re-

quire to be remedied by imposing unjust burdens upon the public.

164 U.S. at 597.

The fact that the rates prescribed for that company were much lower than those allowed for other turnpike companies in the state did not alter that result. As stated by the Court:

> *The circumstances of each turnpike company must determine the rates of toll to be properly allowed for its use.* Justice to the public and to stockholders may require, in respect of one road, rates different from those prescribed for other roads. Rates on one road may be reasonable and just to all concerned, while the same rates would be exorbitant on another road. *The utmost that any corporation, operating a public highway, can rightfully demand at the hands of the legislature* when exerting its general powers is that it receive what, under all the circumstances, *is such compensation for the use of its property as will be just both to it and to the public.*

Id. at 598. (Emphasis added.)

Similarly, Justice Harlan wrote in *Smyth v. Ames*, 169 U.S. 466, 547 (1898):

> What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth.

By contrast, the Appellants' "highest common denominator" approach, under which a utility's rates would

not be deemed exploitative until they were higher than everyone else's, simply disregards the unique and often widely varying costs of service among the utilities of a state or region.

Regardless of one's definition of exploitation, however, the OCA submits that the PUC need not make a specific finding that rates are exploitative in order to remove a non-used and useful plant from rate base.

The whole purpose of rate regulation of public utilities is to prevent exploitation of ratepayers. Without such regulation, monopoly utilities could essentially charge whatever price they could extract from captive ratepayers for needed public utility services. It was in response to this threat of exploitation that Congress and the state legislatures established various methods of rate regulation. *See, e.g., Munn v. Illinois,* 94 U.S. 113 (1876). As stated, for example, by the Supreme Court with respect to the Natural Gas Act in the *Hope* decision:

> The primary aim of this legislation was to protect consumers against exploitation at the hands of natural gas companies.

320 U.S. at 610.

It is through the development and application of ratemaking principles—such as the used and useful principle —that regulators insure that exploitation does not occur. Thus, as stated by the Pennsylvania Supreme Court in the Opinion here under review:

> The "used and useful" principle is soundly based for *it serves to protect consumers from exploitation,* and it comports with the view that, in fairness, con-

> sumers should not be required to buoy up failing utility companies by being required to, in effect, provide public subsidies for utility properties that are not useful in the public service.

Appellants' Appendix at A10. (Emphasis added.)

The OCA submits that it would indeed be exploitative to charge consumers rates which provide not only a substantial return on the utilities' used and useful investments, but also a return on investments which, for one reason or another, are of no use to the ratepayers. It is the essence of exploitation for a utility in a monopoly position to force its ratepayers (who generally have no alternative sources for essential utility services) to pay not only for the full cost of providing utility service to them, but *also* to provide a return on property which is owned by the utility's investors, but which provides no service to the ratepayers.

In sum, the OCA submits that the Appellants are incorrect in arguing that investor interests in a utility's financial integrity must always prevail over ratemaking principles *unless* it is found that the rates requested would exploit ratepayers. Moreover, even if this were the standard, the abandonment of the used and useful principle as proposed by Appellants here would lead to the very kind of exploitation that rate regulation was intended to prevent.

E. The companies' economic arguments against the application of the used and useful principle are misplaced and incorrect.

In stating the basis for this Court's jurisdiction in this case, Appellants acknowledge that "the actions of the PUC

are the equivalent of a statute of Pennsylvania for jurisdictional purposes." Jurisdictional Statement at 3.

Despite this fact, and despite the Appellants' apparent recognition that "the Court's review of State statutes is limited," *id.* at 18, the Appellants have made a number of economic arguments that can only be described as an attempt to have this Court stand in the shoes of the Pennsylvania Public Utility Commission.

For example, the Appellants argue at pages 15-16 of their Jurisdictional Statement that:

> The "used and useful principle" is being increasingly invoked to justify a breach of the implicit and fundamental bargain between investors in the securities of electric utilities and the utilities' customers. It is resulting in the expropriation of millions of dollars of investment with no excuse other than the glib "used and useful" phrase. Assuming that rationality will prevail among investors in the long run, one can anticipate that the cost of electric power will be increased and its availability reduced.

(Footnote omitted.)

This argument, though totally incorrect in the OCA's view, would certainly be relevant to a public utility commission or state legislature in determining whether to adopt the used and useful standard in a particular case or statute. (In Pennsylvania, it should be noted, the used and useful principle has been established both in case law and under the explicit terms of the Commonwealth's Public Utility Code. *See, e.g.*, 66 Pa. Cons. Stat. Ann. §1310 (Purdon 1979), §1315 (Purdon Supp. 1985); *Philadelphia Electric Co. v. Pa. PUC*, 61 Pa. Commonwealth Ct. 325, 433 A.2d

620 (1981); *Bell Telephone Co. of Pennsylvania v. Pa. PUC*, 47 Pa. Commonwealth Ct. 614, 408 A.2d 917 (1979); *Schuykill Valley Lines, Inc. v. Pa. PUC et al.*, 165 Pa. Superior Ct. 393, 68 A.2d 448 (1949).)

To ask this Court to accept this type of argument on appeal, however, is to ask the Court to substitute its economic and policy judgments for those of the Pennsylvania General Assembly and Public Utility Commission. As stated by Justice Black, however, in his Opinion for the Court in *Ferguson v. Skrupa*, 372 U.S. 726, 731-32 (1962):

> We refuse to sit as a "super legislature to weigh the wisdom of legislation," and we emphatically refuse to go back to the time when courts used the Due Process Clause "to strike down state laws, regulatory of business and industrial conditions, because they may be unwise, improvident, or out of harmony with a particular school of thought." Nor are we able or willing to draw lines by calling a law "prohibitory" or "regulatory." Whether the legislature takes for its textbook Adam Smith, Herbert Spencer, Lord Keynes, or some other is no concern of ours.

(Footnotes omitted.)

Contrary to the Appellants' arguments here, the OCA submits that the application of the used and useful principle in this case was eminently fair and reasonable. Investors have been—or at least should have been—long aware of the basic principle of public utility regulation in Pennsylvania and throughout the Nation, that they are entitled to earn a return from ratepayers *only* on investment which is used and useful in providing utility service. The

risk that some investments will not produce a return either temporarily or permanently is a risk that has been and continues to be taken by all private investors in public utilities. Moreover, it is a risk for which investors traditionally have been compensated through the allowance of rates of return on utility securities which are higher than the rates of return they would receive from more risk-free investments.

Whether or not the Court agrees with the Appellants' economic theories, however, is clearly beside the point. As stated by Justice Black in *Ferguson v. Skrupa*:

> Under the system of government created by our Constitution, it is up to legislatures, not courts, to decide on the wisdom and utility of legislation.

372 U.S. at 729.

The OCA submits that the utilities' economic arguments are without merit and, in any case, are not dispositive of the constitutional determination in this matter.

CONCLUSION

Two years ago, this Court dismissed, for want of a substantial federal question, the appeal of Jersey Central Power & Light Company on the virtually identical factual and legal issues raised by the Appellants in this proceeding. *Jersey Central Power & Light Co. v. Board of Public Utilities,* 466 U.S. 947 (1984). The similarity in these proceedings is, of course, not a coincidence. The two cases involve the same utility holding company; the same utility plant; and virtually the same legal arguments. Only the

name of the appellant has changed, since the first case involved General Public Utilities' New Jersey operating subsidiary, while the present appeal involves GPU's two Pennsylvania subsidiaries.

It is also not surprising that the New Jersey and Pennsylvania regulatory commissions and courts reached essentially the same results in these proceedings. For many years, the principle that public utilities may only demand a return from ratepayers on investments which are used and useful in the public service has been firmly ingrained in the public utility law of Pennsylvania and New Jersey as well as most of the state and federal regulatory jurisdictions in this Nation. This principle also is consistent with the constitutional requirements enunciated by this Court in *Denver Union Stock Yard,* supra, and serves as the most rational basis for balancing the interests of investors and ratepayers in deciding what level of rates is just and reasonable in a particular case.

Nothing in this Court's opinion in *FPC v. Hope Natural Gas* provides support for Appellants' assertion that the constitutional rights of investors have been violated in this case. Whether or not the rate increase requested by the utilities would be deemed "exploitative," the *Hope* opinion provides the utilities with no right—constitutional or otherwise—to demand a return from ratepayers on property which provides no utility service.

The legal arguments raised by Appellants in this case are without merit, and the economic arguments are not only flawed, but would invoke a standard of substantive due process review of state legislative policies that was abandoned by this Court several decades ago.

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Argument

In light of this Court's dismissal of the virtually identical appeal two years ago, and for the reasons set forth above, the Pennsylvania Office Consumer Advocate respectfully urges this Honorable Court to dismiss this appeal of Metropolitan Edison Company and Pennsylvania Electric Company. Alternatively, it is requested that this Court affirm the December 9, 1985, Opinion of the Pennsylvania Supreme Court below.

Respectfully submitted,

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No. 85-1493

In the Supreme Court of the United States

October Term, 1985

METROPOLITAN EDISON COMPANY,
Appellant
v.
PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee
OFFICE OF CONSUMER ADVOCATE et al.,
Intervenors

PENNSYLVANIA ELECTRIC COMPANY,
Appellant
v.
PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee
OFFICE OF CONSUMER ADVOCATE et al.,
Intervenors

On Appeal From the Supreme Court of Pennsylvania

MOTION OF THE PENNSYLVANIA PUBLIC UTILITY COMMISSION TO DISMISS OR AFFIRM

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On Appeal From the Supreme Court of Pennsylvania

MOTION OF THE PENNSYLVANIA PUBLIC UTILITY COMMISSION TO DISMISS OR AFFIRM

The Appellee Pennsylvania Public Utility Commission respectfully moves pursuant to Rules 16.1(b) and (d) to dismiss the appeal or for summary affirmance of the final judgment of the Supreme Court of Pennsylvania on the grounds (1) that the decision below correctly applied the relevant constitutional principles, (2) that the question presented does not require plenary consideration by this Court, and (3) that an attempted appeal, based on the same question presented and the same holding arising out of New Jersey, was dismissed by this Court for want of a substantial federal question.

COUNTER-STATEMENT OF THE CASE

Any statement of facts regarding this appeal must begin with the March 28, 1979 nuclear accident at Three Mile Island Generating Unit No. 2 (TMI-2). As a result of that accident TMI-2 sustained serious damage and has not generated electric power since that date. The accident involved the near melt-down of a nuclear reactor, and was the most serious in the history of commercial nuclear power generating facilities in the United States. Moreover, the severity of the accident has raised a host of difficult issues regarding plant safety, management integrity, public utility rate regulation and national energy policy. The following represents a concise chronology of the facts related to the rate regulation issues raised by the accident.

Metropolitan Edison Company (Met Ed) and Pennsylvania Electric Company (Penelec), wholly-owned subsidiaries of General Public Utilities Corporation (GPU), are public utilities subject to the jurisdiction of the Pennsylvania Public Utility Commission (Commission). In its initial response to the accident, the Commission, by order adopted April 19, 1979, reduced Met Ed's rates by setting temporary rates based on the exclusion from cost of service of Met Ed's 50% share of TMI-2 capital and operating costs. Similarly, by order adopted April 25, 1979, the Commission reduced Penelec's rates by setting temporary rates based on the exclusion from cost of service of Penelec's 25% share of TMI-2 capital and operating costs. These actions were in accord with the well-established principle that consumer rates should include only

the legitimate costs associated with facilities used and useful in providing service to the public. *Philadelphia Electric Co. v. Pa. P. U. C.*, 61 Pa. Commonwealth Ct. 325, 329, 433 A.2d 620, 623 (1981).

After further investigation, by order adopted June 15, 1979 at Docket No. I-79040308, the Commission determined that TMI-2 was no longer used and useful in the public service and that the existing temporary rates for Met Ed and Penelec should be made permanent. At the same time, the Commission also determined that customer rates should be increased, through operation of the energy cost rate (ECR), to cover the substantial cost of additional electric power purchased from other utilities to replace the electric power formerly generated by TMI-2. With respect to TMI-1, that unit was out of service for a scheduled refueling when the accident occurred but was not damaged in the course of the TMI-2 accident. Although TMI-1's return to service was being delayed due to its design similarity with and close proximity to TMI-2, GPU president Herman Dieckamp testified on behalf of Met Ed and Penelec that resumption of electric power generation at TMI-1 would occur as early as August 1979 and certainly no later than January 1, 1980. Based principally upon this assurance, the Commission concluded that no action with respect to TMI-1 was warranted at that time. *Pa. P. U. C. v. Metropolitan Edison Co. and Pennsylvania Electric Co.*, 29 PUR 4th 502 (1979).

During the succeeding months several additional matters arose and were consolidated with the Commission's continuing investigation at Docket No. I-79040308: (1) on September 20, 1979 the Commission ordered Met Ed and Penelec to show cause why TMI-1 should be con-

sidered used and useful in the public service, (2) on November 1, 1979 the Commission ordered Met Ed only to show cause why its certificate of public convenience should not be revoked and (3) also on November 1, 1979 Met Ed and Penelec petitioned the Commission for an increase in their existing energy cost rates. By order adopted May 23, 1980, after extensive hearings, briefing and oral argument on these issues, the Commission reached the following conclusions.

First, the Commission concluded that since there was no immediate and foreseeable threat to the continued provision of adequate and reliable service at reasonable rates, Met Ed's certificate of public convenience should not be revoked. The record demonstrated that with the cash available from operation of the energy cost rate and short-term loans from a consortium of banks, Met Ed was able to finance the necessary outside power purchases to maintain service to the public.

Second, the Commission concluded that TMI-1 was no longer used and useful in the public service. The Commission found that TMI-1 would return to service no earlier than January 1, 1981 (an outage of nearly two years) and that proceedings before the Federal Nuclear Regulatory Commission (NRC) regarding plant safety and management integrity threatened to delay TMI-1's return to service well beyond 1983. Pursuant to this finding, the Commission reduced the base rates of Met Ed and Penelec by setting temporary rates which excluded from cost of service the capital and operating costs of TMI-1.

Third, the Commission concluded that Met Ed and Penelec should be allowed to recover on a fully current

basis all of their purchased power costs through a further increase in their energy costs rates, plus all of their previously deferred energy costs over an 18-month period by means of a surcharge to base rates. This action allowed Met Ed and Penelec to continue collecting sufficient revenues from customers to fund all of the additional purchased power costs arising from the out-of-service status of TMI-1 and TMI-2. *Pa. P. U. C. v. Metropolitan Edison Co. and Pennsylvania Electric Co.*, 37 PUR 4th 77 (1980).

On July 29, 1980, in response to the Commission's May 23, 1980 order, Met Ed and Penelec filed complaints against the temporary rates set in that order alleging that such rates were unjust and unreasonable. They also filed the two rate cases which are the subject of this appeal: a requested $76.5 million increase in base rates for Met Ed and a requested $67.5 million increase in base rates for Penelec. The requested rate increases were grounded upon general increases in capital and operating costs associated with non-TMI plant that were experienced since the last rate cases, plus recovery of the capital and operating costs of TMI-1 based on the utilities' estimate that TMI-1 would return to service shortly after March 31, 1981—the end of the future test year in these rate cases.[1] No claim was made for the capital and operating costs of TMI-2 or for the uninsured costs of TMI-2 decontamination.[2]

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[1] TMI-1 did not return to service until October 3, 1985, an outage of more than six years.

[2] According to GPU, the total cost of TMI-2 decontamination will be approximately $1 billion; TMI-2, of course, remains out of service.

The complaints against temporary rates and the two rate cases were consolidated for hearing purposes. By orders adopted June 8, 1981, the Commission dismissed the complaints against the temporary rates set May 23, 1980, holding that Met Ed and Penelec had not met their burden of proving that the temporary rates were unjust and unreasonable during the time they were in effect. On appeal to the Commonwealth Court of Pennsylvania the Commission's decision was affirmed; no further appeal was taken regarding the temporary rates issue.

By order entered July 27, 1981, the Commission concluded its consideration of the two rate increase requests finding that Met Ed and Penelec were entitled to rate increases of $51.8 million and $55.4 million, respectively. Finding that TMI-1 would not return to service during the test year or within a reasonable time thereafter, the Commission held that TMI-1 was still not used and useful in the public service and, therefore, that TMI-1 operating and capital costs should be excluded from the computation of just and reasonable rates. However, in balancing the interests of investors and consumers, the level of consumer rates approved by the Commission included, among other things, $16.5 million per year for TMI-1 restart expenses, relatively high rates of return on the used and useful portion of the utilities' property and full recovery of the additional purchased power costs caused by the out-of-service status of TMI-1 and TMI-2.

On August 17, 1981, Met Ed and Penelec filed with the Commonwealth Court of Pennsylvania petitions for review of the Commission's final rate order entered July 27, 1981. On November 18, 1983, the Commonwealth Court of Pennsylvania affirmed the Commission's rate deter-

minations for Met Ed and for Penelec finding that the Commission did not abuse its discretion in excluding TMI-1 capital and operating costs from the computation of consumer rates and that the actions of the Commission reflect an appropriate balance of investor and consumers interests. *Pennsylvania Electric Co. v. Pa. P. U. C.*, 78 Pa. Commonwealth Ct. 402, 467 A.2d 1367 (1983).

On December 16, 1983, Met Ed and Penelec filed with the Supreme Court of Pennsylvania a joint petition for allowance of appeal, which petition was granted on April 19, 1984. By opinion filed December 9, 1985, the Supreme Court of Pennsylvania also affirmed, finding that the Commission had satisfied the constitutional requirement of "just and reasonable" rates by appropriately balancing investor and consumer interests in its ratemaking determinations. Furthermore, the Court held that the investor interests described in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), were not in and of themselves of constitutional dimension but, rather, "are among the factors to be taken into account in the balancing of interests process." Appellants' Appendix, A1-12.

ARGUMENT

I. As in an Earlier Appeal Arising out of New Jersey Involving the Same Relevant Facts and Holding, This Court Should Dismiss the Appeal for Want of a Substantial Federal Question

The same investor-oriented interpretation of the *Hope* case advanced by Met Ed and Penelec in this appeal has been addressed and rejected by the New Jersey Board of Public Utilities, by the New Jersey Appellate Courts and, by implication, the United States Supreme Court.

Jersey Central Power & Light Company (Jersey Central), another GPU subsidiary, owns the remaining 25% interest in TMI-1 and TMI-2. And, as in Pennsylvania, the New Jersey Board of Public Utilities (New Jersey Commission) removed TMI-1 and TMI-2 from rate base to ensure that Jersey Central's consumers would not bear the double burden of providing the company with capital and operating expenses related to the idle TMI units while at the same time bearing the substantial additional costs of replacing the electric power formerly produced by such units.

On appeal to the Superior Court of New Jersey, Jersey Central argued that the New Jersey Commission failed to establish rates which comported with requirements of the federal and state constitutions under the standards set forth in the *Hope* case. The Superior Court of New Jer-

sey, after analyzing in great detail the *Hope* case, supra, and *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), rejected Jersey Central's argument in all respects. The New Jersey Court held that the investor interests described in *Hope* are to be considered only in tandem with consumer interests and that, in and of themselves, investor interests are not of constitutional dimension. *In re Jersey Central Power & Light Co.*, No. A-162-81T2 (July 28, 1983), *cert. den.* 95 N.J. 217, 470 A.2d 433 (1983). In so holding, the New Jersey Court relied upon the following language from the *Permian Basin* case.

> The Commission cannot find its inquiries either to the computation of cost of service or to conjectures about the prospective responses of the capital market; it is instead obligated at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection by Congress. Accordingly, the "end result" of the Commission's orders must be measured as much by the success with which they protect those interests as by the effectiveness with which they "maintain credit . . . and . . . attract capital."

Id. at 791. (Footnote omitted.)

After the Supreme Court of New Jersey declined to review the decision, Jersey Central sought an appeal to the United States Supreme Court and offered the following question for the Court's plenary consideration:

> Was the Court below correct in holding that the three investor-interest components of the criteria for determining whether electric utility rates are "just and reasonable" as specified by this court in Federal

> Power Commission v. Hope Natural Gas Company, 320 U.S. 591, 603 (1944) "are not of constitutional dimension", even though rates which would satisfy such investor-interest criteria would not exploit customers?

Jersey Central Jurisdictional Statement, No. 83-1478 (March 4, 1984).

The New Jersey Commission argued in opposition that the Superior Court of New Jersey properly upheld the exclusion of TMI from rate base as no longer used and useful in the public service, that investor and consumer interests were balanced appropriately in its ratemaking determinations and that no substantial constitutional question had been presented. In *Jersey Central Power & Light Co. v. Board of Public Utilities of New Jersey*, 466 U.S. 947 (1984), Jersey Central's appeal was dismissed by this Court for want of a substantial federal question.

Unlike the denial of certiorari, summary disposition of an appeal either by affirmance or dismissal for want of a substantial federal question is a disposition on the merits and, as such, it is binding on the lower Courts. *Hicks v. Miranda*, 422 U.S. 332, 343-44 (1975). Moreover, summary dismissal for want of a substantial federal question rejects the specific constitutional challenge presented and leaves undisturbed the judgment of the lower Court based on the application of established constitutional principles to the current facts. *Mandel v. Bradley*, 432 U.S. 173, 176 (1977).

The Commission submits that there can be no serious question that the relevant facts and holding in this appeal are identical to those in the appeal arising out of the New

Jersey Commission's ratemaking response to the accident at TMI-2. In each instance, the state regulatory commission excluded from customer rates the operating and capital cost associated with the idle generating facilities at TMI-1 and TMI-2 and, at the same time, allowed customer rates to include the substantial additional costs of purchased power. Moreover, both in New Jersey and in Pennsylvania the Appellate Courts ruled that while the investor interests described in *Hope* are to be considered in discharging their duty to establish "just and reasonable" rates, those investor interests are not, in and of themselves, of constitutional dimension, but must be considered in tandem with consumer interests. The Pennsylvania Supreme Court went so far as to state unequivocally that the holding of the Superior Court of New Jersey is "identical to that which we have reached presently." Appellants' Appendix, A12.

The substantive question presented in this appeal by Met Ed and Penelec is identical to the question presented in the appeal sought by Jersey Central, their sister company, and dismissed by this Court. The only literal difference to be found is an absence of the phrase "even though rates which would satisfy such investor-interest criteria would not exploit consumers" in the version drafted by Met Ed and Penelec. The body of their argument, however, makes clear that this is still an important aspect of the issue as they see it. *See* Jurisdictional Statement, pp. 5, 11, and 16.

Rather than rely on this Court's dismissal of the appeal arising out of the New Jersey jurisdiction, Met Ed and Penelec have simply reasserted the erroneous contention that investor interests are of constitutional di-

mension and may supersede consumer interests under certain circumstances. Indeed, it is only the fortuitous fact that the capital and operating costs of TMI are assigned to two state jurisdictions that allows these companies "two bites at the apple." The Commission suggests that the constitutional arguments raised by Met Ed and Penelec in opposition to consumer rates that exclude the capital and operating costs of the idle TMI units are no more compelling in this instance than when they were first made on behalf of Jersey Central.

Therefore, given the identity of facts and holdings between this appeal and the New Jersey appeal, and this Court's summary dismissal of the New Jersey appeal for want of a substantial federal question, this appeal should be dismissed as well.

II. The Pennsylvania Supreme Court Held Correctly That the Investor Interests Enumerated in HOPE Are Not Paramount, but Are Among the Factors To Be Taken Into Account in Determining Just and Reasonable Rates

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The judgment of the Pennsylvania Supreme Court, which upheld rate orders excluding from consumer rates the costs associated with the idle generating facilities at TMI-1 and TMI-2, is consistent in all respects with the precedents of this Court and with the protections afforded to investors and consumers through the Fifth and Fourteenth Amendments to the United States Constitution.

In the landmark case of *Smyth v. Ames*, 169 U.S. 466 (1898), the United States Supreme Court established that the constitutional standard for judging the reasonableness and adequacy of public utility rates was grounded upon

"the fair value of the property being used by it for the convenience of the public." *Id.* at 546. And, although the particular method of determining a "fair value" rate base outlined in the *Smyth v. Ames* decision has since lost its importance, the concept of a properly determined rate base, a rate base consisting of used and useful property, has never lost its vitality. Indeed, Met Ed and Penelec are seriously mistaken in asserting that the *Hope* decision has overruled this principle.

Federal case law on the subject of ratemaking and confiscation, both before and after *Hope*, has consistently held to the principle that a utility is entitled to a return only on property that is used and useful in the public service. In *Bluefield Water Works v. PSC of West Virginia*, 266 U.S. 679, 692-93 (1923), this Court held that a public utility is constitutionally entitled to rates sufficient to earn a return on the value of property which it employs for the convenience of the public equal to the returns on investment earned by firms of similar risk. Later, in *Denver Union Stock Yard Co. v. United States*, 304 U.S. 470 (1938), this Court held that the reasonableness of rates was to be judged in relation to the property used and useful in the public service.

> *The Rate Base.* As of right safeguarded by the due process clause of the Fifth Amendment . . . appellant is entitled to rates . . . sufficient to yield a reasonable rate of return upon the value of property used, at the time it is being used, to render the services (citations omitted). But it is not entitled to have included any property not used and useful for that purpose.

Id. at 475.

> And after *Hope*, the principle remained the same.
>
> Although methods for determining values of rate base items have evolved since Smyth v. Ames, the precept endures that an item may be included in rate base only when it is "used and useful" in providing service. In other words, current ratepayers should bear only legitimate costs of providing service to them.

Tennessee Gas Pipeline Co. v. FERC, 606 F.2d 1094, 1109 (D.C. Cir. 1979), *cert. den.*, 445 U.S. 920, 447 U.S. 922 (1980). Similarly, in *Kentucky Utilities Co. v. FERC*, 760 F.2d 1321, 1324 n.4 (D.C. Cir. 1985), the court noted that the used and useful principle established in *Smyth v. Ames* remained as "a bedrock principle of utility rate regulation" which required that "costs associated with electric power plants be paid by the ratepayers who benefit from the plant."

In this case there can be no doubt that the Commission acted reasonably and within its sound discretion when it determined that TMI-1 would not provide electric power to consumers in the reasonably foreseeable future and, therefore, that TMI-1 was not used and useful in the public service. The record demonstrated without contradiction that TMI-1 had been out of service since March 28, 1979 (the date of the nuclear accident at TMI-2), that the utilities' own estimate of the date TMI-1 would return to service was toward the end of the fourth quarter of 1981 (approximately nine months after the end of the future test year) and that the utilities' estimate was based on certain optimistic assumptions regarding proceedings before the NRC. As it turns out, TMI-1 did not return to service until October 3, 1985. The rates established by the

Commission, and approved by the Pennsylvania Supreme Court, properly excluded the capital and operating costs of non-used and useful property in discharging its responsibility to establish just and reasonable rates.

Citing certain language in the 1944 *Hope* decision regarding the nature of investor interests, Met Ed and Penelec suggest that they are constitutionally entitled to rates sufficient to assure their financial integrity regardless of the used and useful status of their property, provided that such rates do not "exploit consumers." Jurisdictional Statement, p. 16. Their theory of ratemaking is without foundation.

After nearly fifty years of judicial review regarding details of the ratemaking methods used by regulatory commissions, the Court abandoned this approach and held in *Hope* that, where the legitimate interests of investors are fully satisfied at the level of rates established by the regulatory commission, the utility could not sustain a constitutional challenge to the ratemaking methods used in arriving at those rates.

> Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid even though they might produce only a meager return on the so-called "fair value" rate base.

Id. at 605.

Thus, given the strong financial condition of the utility in that particular case, the so-called "end result", the rates prescribed by the regulatory commission could not

be held as unjust and unreasonable from the investor viewpoint. So understood, it becomes clear that the *Hope* "end result" test is not a substantive rule of ratemaking, but rather a doctrine of judicial restraint. In those cases where the interests of the complaining party are fully satisfied, as they were for the utility in *Hope*, the Court will withhold judicial review of the ratemaking methods used. On the other hand, where the legitimate interests of the complaining party are not met, judicial review remains available to determine whether the regulatory commission properly balanced the competing interests involved.

Investor interests, however, are not paramount. As explained by the Pennsylvania Supreme Court:

> The decision in Hope enumerated certain legitimate areas of concern for investors, these being that a company have sufficient revenue to cover operating and capital costs, that the return on equity be commensurate with returns on enterprises having similar risks, and that the company be able to maintain credit and attract capital. These investor interests are appropriate factors to be weighed in the balancing analysis under Hope, but they are not, in themselves, controlling, for other factors must be taken into account.

Appellants' Appendix, A7.

Rather, in determining just and reasonable rates, the competing interests of investors and consumers must be balanced at each step of the ratemaking process, *Permian Basin* at 790-91, including the determination of the rate base on which a return may be earned. Moreover, con-

sumer interests are not to be discarded if the financial interests of the utility are in peril.

The erroneous interpretation of the *Hope* case advanced by Met Ed and Penelec was addressed and discarded by the United States Supreme Court only one year after *Hope*. In *Market Street Railway Co. v. Railroad Commission*, 320 U.S. 548 (1945), the court dismissed the argument of an ailing transportation utility that regardless of the current depressed value of its properties, it was entitled to a return "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." In rejecting the utility's argument the court held that the considerations in *Hope*

> . . . concerned a company which had the advantage of an economic position which promised to yield what was held to be an excessive return on its investment and on its securities. They obviously are inapplicable to a company whose financial integrity already is hopelessly undermined, which could not attract capital on any possible rate, and where investors recognize as lost a part of what they have put in . . . . Without analyzing rate cases in detail, it may be safely generalized that the due process clause has never been held by this Court to require a commission to fix rates on the present reproduction value of something no one would presently want to reproduce . . . or on an investment after it has vanished, even if once prudently made, or to maintain the credit of a concern whose securities already are impaired. *The due process clause has been applied to prevent governmental destruction of existing economic value. It has not and cannot be applied to*

> *ensure values or to restore values that have been lost by the operation of economic forces.*

Id. at 566-67. (Citations omitted. Emphasis supplied.)

The major error of the theory advanced by Met Ed and Penelec lies in assuming that the *Hope* case, because it carefully described the parameters of investor interests, places *primary* importance on investor interests and therefore eliminates the need to determine the utility's used and useful rate base upon which investors may earn a return. Thus, according to their strained reading of the *Hope* case, the Commission may remove non-used and useful property from rate base but, if the effect is significant damage to investor interests, the Commission is constitutionally required to increase rates to such an extent that the damage to investor interests is cancelled out. The Pennsylvania Supreme Court recognized correctly that if rates which otherwise properly excluded TMI costs from consumer rates had to be adjusted upward to preserve the utility's financial integrity, "the effect upon rates would be the same as if portions of the non-useful property, such as the Three Mile Island nuclear reactors, had not been excluded from the rate base in the first instance." Appellants' Appendix, A9. For all practical purposes, the removal of non-used and useful property from rate base becomes a nullity.

Nor is there any merit to the contention that the Commission was obligated under the United States Constitution to adjust rates upward so long as "such rates would not exploit customers." Jurisdictional Statement, p. 5. Apparently, the standard of consumer exploitation envisioned by Met Ed and Penelec would compare their

rates with "those of other utilities in Pennsylvania and neighboring states." Jurisdictional Statement, p. 10.

In addition to disregarding whether or not the utility's property is used and useful in providing service to the public, this putative standard would effectively set rates based on those of the worst managed and highest cost utilities in the region. Each public utility operates in a different territory, under different operating conditions and, therefore, under different cost conditions. Cost of service is the foremost standard for the establishment of public utility rates. A public utility is entitled to rates that provide recovery of all of its legitimate operating expenses, depreciation and taxes, plus an *opportunity* to earn a fair return on the property which is used and useful in the public service; this represents the utility's revenue requirement. *See* C. Phillips, *The Regulation of Public Utilities* (1984), pp. 157-60; P. Garfield and W. Lovejoy, *Public Utility Economics* (1964), pp. 44-46. There is simply no basis in public utility law or in constitutional law for the proposition that the TMI-1 related costs legitimately disallowed by the Commission may be recaptured by higher consumer rates if the rates do not exceed those of some other utility in the region.

Met Ed and Penelec are also incorrect in their assertion that the used and useful standard represents a "breach of the implicit and fundamental bargain between investors . . . and consumers." Jurisdictional Statement, p. 15. The used and useful standard is soundly based in that it reflects the principle that, in fairness, consumers should not be required to subsidize utility property that does not provide service to the public. Appellants' Appendix, A10. Investors, on the other hand, are risk-takers

by nature, and the fair return portion of a utility's revenue requirement is intended to compensate investors for a variety of business risks, including the risk that the utility's property will not provide service. Excluding TMI-1 costs from consumer rates is fully consistent with the rights of consumers and the risks undertaken by investors.

Furthermore, the Court should note that the financial problems faced by Met Ed and Penelec run far deeper than the exclusion of TMI-1 costs from consumer rates. At the root is the March 28, 1979 nuclear accident at TMI-2; that generating unit sustained serious damage and has been out of service since that date. The operating and capital costs of TMI-2 are not in customer rates, nor have Met Ed and Penelec made any direct claim for these substantial costs in the rate cases. Nevertheless, these substantial costs continue to accrue and serve to weaken their financial position. Then there is the problem of radioactive decontamination. Before TMI-2 can return to service, TMI-2 must be decontaminated at a total cost that may exceed $1 billion. No claim was made in the rate cases for decontamination expenses; that potential liability, however, places a tremendous strain on the financial health and resources of these utilities.

The Commission submits that no principle of constitutional law mandates the replacement of traditional ratemaking principles with an approach that would nullify all otherwise appropriate ratemaking determinations whenever necessary to preserve the financial integrity of the utility. Indeed, such an approach would shift the risk of financial failure from investors to consumers and, in effect, *guarantee a fair return to investors.* This would

be inconsistent with the basic risks undertaken by all private firms in the American economy and, more important, would be inconsistent with the limits of the constitutional protections available to privately owned utilities and their investors.

No such constitutional protection from financial failure can be found in *Hope* or any other decision of this Court. On the contrary, as noted by the Pennsylvania Supreme Court, "the express language of the *Hope* decision weighs against regarding utilities as a protected class of business enterprises which are to be relieved from such normal business risks." Appellants' Appendix, A8. *Hope* teaches that, notwithstanding the regulatory commission's duty to establish just and reasonable rates, "regulation does not insure that the business shall produce net revenues." *Id.* at 603. Moreover, the decision carefully points out that since the investor interests described previously were fully satisfied for the natural gas utility in that case, it was unnecessary to consider "conditions under which more or less might be allowed" or to consider any alternative "rate base on which the return is computed." *Id.* at 603. The *Hope* decision recognizes that there may be constitutionally permissible circumstances in which investor interests are not fully satisfied. As noted in *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 590 (1942), cited with approval in *Hope*, "the hazard that the property will not earn a profit remains on the company in the case of a regulated, as well as an unregulated business."

In this case, it was impossible for the Commission to set rates that would place Met Ed and Penelec in the strong financial condition described in *Hope* without ex-

ploiting consumer interests. Rates sufficient to assure confidence in the financial integrity of these troubled utilities would have required charging consumers with TMI-1 costs, TMI-2 costs and the uninsured portion of TMI-2 decontamination costs, thereby forcing consumers "to ensure values . . . that have been lost by the operation of economic forces." *Market Street* at 567. Indeed, in an earlier brief below Met Ed and Penelec readily admitted that not even the *full measure* of the rate increase sought would have restored Met Ed to financial health.

At the same time, investor interests were not ignored by the Commission in its ratemaking determinations. The record demonstrates that investor interests were balanced against those of consumers at each step of the ratemaking process. Indeed, the Commission took several specific and extraordinary actions designed to aid Met Ed and Penelec in their recovery from the financial problems caused by the nuclear accident at TMI-2.

Despite the out-of-service status of TMI-1, the Commission's final rate orders included $11 million for Met Ed and $5.5 million for Penelec in operating expenses for TMI-1 to aid restart. Thus, while TMI-1 operating and capital costs are excluded from cost of service, $16.5 million in operating expenses are added back to advance the date on which TMI-1 will again be in service and in customer rates.

Second, any consideration of the appropriate balancing of investor and consumer interests must include the fact that for the 14-month period from March 28, 1979 (the date of the accident at TMI-2) through June 1, 1980 (the date TMI-1 costs were removed from customer rates), customer rates included the operating and capital

costs of TMI-1 even though it was out of service during that entire period. At the same time, the Commission had allowed increased customer rates to fund the additional costs of purchased power necessary to replace the generating capacity of TMI-1 and TMI-2.

Third, the Commission's final rate orders provided relatively high rates of return on the common equity investment in used and useful property: 16.5 percent for Penelec and 17.0 percent for Met Ed. At that time, 17.0 percent was the highest rate of return ever allowed a Pennsylvania utility and reflects the substantial financial risks being faced by Met Ed.

Fourth, the Commission left undisturbed the utilities' energy cost rate which generates revenues from consumers sufficient to fund all of the additional purchased power costs caused by the out-of-service status of TMI-1 and TMI-2. In this respect, consumers have borne a substantial portion of the risk of plant failure. The record demonstrates that during the test year in these rate cases, customer rates included purchased power costs of $109 million for Met Ed and $45 million for Penelec.

Finally, the Commission's final rate order provided for reserve capacity expenses for ratemaking purposes in excess of the actual reserve capacity expenses that Met Ed and Penelec would incur during the test period. By ordering normalization of certain reserve capacity expense credits, the Commission had in effect caused customers to loan Met Ed and Penelec $34 million per year to be paid back at some future date in order to improve the utilities' cash flow.

These items demonstrate convincingly the Commission's grave concern with the financial well-being of Met

Ed and Penelec. Without writing a "blank check" to solve all the serious financial problems caused by the March 28, 1979 nuclear accident at TMI-2 (the out-of-service status of TMI-1 and TMI-2, the need to purchase large amounts of replacement power and funding the costs of TMI-2 decontamination), the Commission acted reasonably within the framework and limitations of its rate-making authority to aid the utilities in their financial recovery from the accident. The Commission's final rate orders set just and reasonable rates and reflect an appropriate balance of investor and consumer interests consistent with the constitutional protections afforded to both.

Although Met Ed and Penelec are dissatisfied with the particular balance between investor and consumer interests struck by the Commission, that dissatisfaction alone does not give rise to a substantial federal question requiring review by this Court. Absent a clear conflict with some specific federal constitutional protection, and there is none in this case, the courts will not substitute their social and economic judgment for those of the expert bodies to whom such matters have been entrusted. *Ferguson v. Skrupa*, 372 U.S. 726, 730-31 (1963). In affirming the Commission's rate determinations, the Pennsylvania Supreme Court correctly applied the relevant constitutional standards and, therefore, its final judgment requires no further consideration of this Court.

Argument

CONCLUSION

For the foregoing reasons, the Pennsylvania Public Utility Commission respectfully moves that the appeal should be dismissed or, in the alternative, that the decision below should be affirmed.

Respectfully submitted,

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Supreme Court of the United States

OCTOBER TERM 1985

METROPOLITAN EDISON COMPANY,
Appellant,

—against—

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee,
OFFICE OF CONSUMER ADVOCATE et al.,
Intervenors.

PENNSYLVANIA ELECTRIC COMPANY,
Appellant,

—against—

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee,
OFFICE OF CONSUMER ADVOCATE et al.,
Intervenors.

ON APPEAL FROM THE SUPREME COURT OF PENNSYLVANIA

REPLY OF APPELLANTS TO APPELLEES' MOTIONS TO DISMISS OR AFFIRM

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On Appeal From the Supreme Court of Pennsylvania

REPLY OF APPELLANTS TO APPELLEES' MOTIONS TO DISMISS OR AFFIRM

This brief of Metropolitan Edison Company ("Met-Ed") and Pennsylvania Electric Company ("Penelec"), the appellants, is submitted pursuant to Rule 16.5 in reply to the motions to dismiss or affirm of the Pennsylvania Public Utility Commission (the "PUC") and the Office of Consumer Advocate (the "OCA"), the appellees. Met-Ed and Penelec are sometimes hereinafter referred to as the "Companies."

ARGUMENT

I

The Investor Interests Criteria of *Hope* Are Constitutionally Mandated If Resulting Rates Will Not Exploit Consumers.

This appeal presents the substantial federal question of whether the decision of the United States Supreme Court in *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944) established a requirement, of Constitutional dimension, that utility rates set by regulatory authorities be sufficiently high to maintain the financial integrity of the utilities involved if such rates would not exploit customers.

Since the decision in *Hope* forty-two years ago, this Court has generally been reluctant to review the ratemaking actions of state agencies and courts. Indeed, the *Hope* decision was clearly intended to leave the selection and application of complex rate-setting methodologies in the experienced hands of state regulatory bodies. *Hope* coupled such freedom, however, with the mandate that ratemakers balance the interests of utility customers and investors so as to achieve a "just and reasonable" end result. *Id.* at 602.

Hope recognized that utility customers are entitled to rates that are not exploitative. *Id.* at 612. Similarly, it recognized that the investors' legitimate interest is a level of rates which will provide the utility with an opportunity to receive revenues sufficient not only to meet operating expenses and capital costs, but also to assure confidence in the financial integrity of the enterprise so as to maintain credit and attract capital. *FPC* v. *Memphis Light, Gas & Water Division*, 411 U.S. 458, 465-66 (1973) (Douglas, J., the author of *Hope*, summarizing its holding for a unanimous Court).

Because *Hope* found that the investor interests were satisfied in that case, it did not explore the "conditions under which more or less might be allowed." 320 U.S. at 603. As a result, state courts have had little guidance when confronted with a situation, such as the one here presented, in which a public utility commission has refused to set rates at a level which enables the utility to pay dividends on stock, maintain credit, and attract new capital, even though the commission did not find that higher rates would have exploited the utility's customers.

In this case, appellees do not assert that the PUC's orders preserved the Companies' financial integrity and ability to attract capital or that the PUC determined that the Companies' proposed rate increases would have been unreasonable to the public. Appellees argue only that the investor interests specified in *Hope* are not "constitutionally mandated." OCA Brief at 12; PUC Brief at 12-13.*

The *Hope* opinion is to the contrary. Just prior to its discussion of the investor interest components of the criteria for determining whether rates are "just and reasonable," *Hope* quoted from this Court's decision two years earlier in *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 585-86 (1942), which held that the "just and reasonable" standard prescribed by the Natural Gas Act "coincides with that of the Constitution."

Moreover, in its discussion of investor interests, *Hope* cites, and in many respects paraphrases, the following passage from the opinion of Justice Brandeis in *Missouri ex rel. Southwestern Bell Telephone Co.* v. *PSC*, 262 U.S. 276, 291 (1923):

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*In addition, the PUC argues in its brief that "[r]ates sufficient to assure confidence in the financial integrity of these troubled utilities would have required charging consumers with TMI-1 costs, TMI-2 costs and the uninsured portion of TMI-2 decontamination costs. . . ." PUC Brief at 23. If the record supported such a finding, the PUC should have reached this conclusion a long time ago. The PUC misleads this Court by making such an unsupported and improper statement now.

> The compensation *which the Constitution guarantees an opportunity to earn* is the reasonable cost of conducting the business. Cost includes not only operating expenses, but also capital charges. Capital charges cover the allowance, by way of interest, for the use of the capital, whatever the nature of the security issued therefor; the allowance for risk incurred; and enough more to attract capital. The reasonable rate to be prescribed by a commission may allow an efficiently managed utility much more. But a rate is *constitutionally compensatory*, if it allows to the utility the opportunity to earn the cost of the service as thus defined. (Emphasis added).

Just one page earlier, Justice Brandeis stated:

> The thing devoted by the investor to the public use is not specific property, tangible and intangible, but capital embarked in the enterprise. Upon the capital so invested *the Federal Constitution guarantees* to the utility the opportunity to earn a fair return.[2] Thus, it sets the limit to the power of the State to regulate rates. (Emphasis added).*

Subsequently, in *Permian Basin Area Rate Cases*, 390 U.S. 747, 770 (1968), this Court again stated that the "just and reasonable" standard construed in *Hope* "coincides" with applicable Constitutional standards. In *FPC* v. *Memphis Light, Gas & Water Division*, 411 U.S. at 474, the Court reaffirmed that

> under *Hope Natural Gas* rates are "just and reasonable" only if consumer interests are protected and if the financial health of the pipeline in our economic system remains strong.

From the outset of the proceedings before the PUC, Met-Ed and Penelec demonstrated that the rates necessary to preserve

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*Footnote 2 to this passage qualifies a utility's Constitutional guarantee exactly as the Companies do here:

> Except that rates may, in no event, be prohibitive, exorbitant, or unduly burdensome to the public. (Citations omitted).

their financial health would not "exploit" their customers. To that end, the Companies submitted evidence that, even if their proposed rate increases were granted in full, the rates would be in conformity with those of other electric utilities in Pennsylvania and neighboring states. While Met-Ed and Penelec agree with appellees that each rate case must stand on its own, the rates set for similar companies operating within the same area certainly provide a touchstone for assessing whether the requested increases were unreasonable.*

Appellees persist, as did the Supreme Court of Pennsylvania, in mischaracterizing the Companies' position. The Companies have never asserted that investor interests are "paramount" or "supersede consumer interests." PUC Brief at 13, 17. Nor have the Companies asked for rate increases that would place them in the "strong financial condition" of the entity in *Hope*. PUC Brief at 22-23. Rather, the Companies' position is that since the PUC did not find—and on the record before it could not find—that their requested rate increases were exploitative, the interests of the Companies' investors described in *Hope* are Constitutionally mandated and not, as the Pennsylvania Supreme Court held, merely "factors to be taken into account." A11.**

Hope requires that the PUC do more than consider investor interests. It requires the PUC to "balance" those interests with the interests of consumers. 320 U.S. at 603. Because the PUC failed to determine the level of rates which would exploit con-

*The PUC's gratuitous comment that this standard "would effectively set rates based on those of the worst managed and highest cost utilities in the region" totally lacks substantiation in the record of this case or elsewhere. PUC Brief at 20.

**In view of its determination that "Hope did not establish investor interests of constitutional dimension," the Pennsylvania Supreme Court deemed it unnecessary to remand this case to the PUC for further findings of fact that would more adequately permit appellate review as to whether the investor interests set forth in *Hope* have been satisfied by the PUC's rate orders. A11.

sumers, it could not—and did not—achieve the requisite balancing.

II

The "Used and Useful" Test May Not Be Employed To Bar the "Balancing" of Interests Required By *Hope*.

The Pennsylvania Supreme Court miscomprehended the Companies' argument to be that *Hope* requires the setting of rates at a level which will guarantee the Companies' continued financial integrity regardless of countervailing consumer interests. A4, 6. The Companies, however, never contended that there must be an assurance of their financial integrity or concomitant ability to generate profits. Instead, the Companies contend that, under *Hope*, the PUC was Constitutionally obligated to afford them a fair opportunity to operate successfully, compensate investors, and attract new capital so long as ratepayers were not exploited in the process. The Companies further submit that the "used and useful" test attributable to this Court's nineteenth century opinion in *Smyth* v. *Ames*, 169 U.S. 466 (1898) does not excuse a ratemaking agency from satisfying the *Hope* criteria for determining whether the end result of a rate order is "just and reasonable."

In essence, the approach taken by the PUC means that where regulatory commissions find that property is not "used or useful," there can be no "taking" in the Constitutional sense even if the investment in the plant was prudently made. This approach takes what may have been an appropriate element of the "fair value" rule of *Smyth* and confounds it with the "prudent investment" criterion for ratemaking—a criterion that focuses on the investment *in* the enterprise rather than on any particular property employed *by* the enterprise.

The "used and useful" doctrine operates on the basis of hindsight; consumers receive a substantial benefit if a utility makes a successful investment but do not bear the cost of unsuccessful investments. While this approach is consistent with the "fair

value" rule which allows investors the benefit of increased rates if the value of the property appreciates, it is irrelevant to the "prudent investment" approach of *Southwestern Bell*—an approach now nearly universally employed in the United States.

Neither the PUC nor the OCA cites any decision of this Court since *Hope* in support of its view that a proper application of the *Smyth* "used and useful" principle makes ratemaking immune from attack. This is not surprising because the decisions of this Court do not pass on whether the result of any particular methodology of ratemaking is necessarily valid or invalid; they only permit commissions to choose whatever methodology they deem appropriate. *See, e.g., Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581, 601 (1945):

> We do not say that the Commission lacks the authority to depart from the rate base method. We only hold that the Commission is not precluded from using it.

See also Permian Basin, 390 U.S. at 805 (upholding rates fixed by a rate base method which differed significantly from that frequently preferred by regulatory authorities).

Thus, the PUC has complete discretion to employ or to depart from the "used and useful" rubric.* But if employment of the "used and useful" method overrides *Hope's* requirement to balance investor and consumer interests, it eviscerates the *Hope* holding.

The PUC never sought to ascertain whether the rates sought by Met-Ed and Penelec would exploit their customers, just as it steadfastly refused to measure the impact of its rate orders by the

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*See *Washington Gas Light Co.* v. *Baker*, 188 F.2d 11, 19 (D.C. Cir. 1950), *cert. denied*, 340 U.S. 952 (1951), where the court stated that the "used and useful" standard is not a requisite part of the prudent investment theory and that inclusion of even abandoned plant in rate base "may be necessary to assure efficiency and progress in the art and the continued attraction of capital to the enterprise."

investor interest criteria of *Hope*. Indeed, precisely because the PUC focused on methodology and not on end result, it failed to strike the balance required by *Hope*.

III

Appellees' Reliance Upon *Market Street Railway* Is Misplaced.

Appellees heavily rely upon this Court's decision in *Market Street Railway* v. *Railroad Commission*, 324 U.S. 548 (1945). In *Market Street*, however, the Court noted that

> . . . most of our cases deal with utilities which had earning opportunities, and public regulation curtailed earnings otherwise possible. But if there were no public regulation at all, *this appellant would be a particularly ailing unit of a generally sick industry*. The problem of reconciling the patrons' needs and the investors' rights in an enterprise *that has passed its zenith of opportunity and usefulness, whose investment already is impaired by economic forces,* and *whose earnings possibilities are already invaded by competition from other forms of transportation, is quite a different problem.*

Id. at 554 (emphasis added). The Court also pointed out that a prior increase in fares had not halted the decline in the street railway's traffic and revenue. *Id.* at 555.

The railway in *Market Street* was "hopelessly undermined," "could not attract capital on any possible rate," and had been effectively replaced by a more efficient municipal line. *Id.* at 566. In contrast, there exists today an urgent public need for electric service. The inability of Met-Ed and Penelec to achieve earnings that would meet the *Hope* criteria is solely attributable to the inadequate rates set by the PUC and not to outside economic factors such as existed in *Market Street*.

IV

The Issue Here Presented Is a Recurring Question of Substantial Public Importance.

Appellees attempt to make much of the fact that a similar issue was raised in a Jurisdictional Statement filed by an affiliate of appellants in *Jersey Central Power & Light Company* v. *Board of Public Utilities*, October Term 1983, No. 83-1478. They do not, however, deny the importance of the issue raised and, indeed, the instant case is one of a series of cases involving the question of whether there has been a confiscation of the property of public utility investors. *See, e.g., Jurisdictional Statement of Northern Indiana Public Service Company*, October Term 1985, No. 85-1610 and the cases cited therein. Nor has this question been limited to state courts. *See Jersey Central Power & Light Co.* v. *FERC*, 730 F.2d 816 (D.C. Cir. 1984), *rev'd on reh'g*, 768 F. 2d 1500, *vacated for reh'g en banc*, 776 F.2d 364 (1985), now pending before the Court of Appeals for the District of Columbia Circuit.

The decision in *Hope* was a valuable corrective to the all too frequent involvement of federal courts in ratemaking activities over the previous fifty years. It has recently developed, however, that state courts are not giving adequate attention to the requirements of investor interests and need to be reminded of *Hope*'s continuing vitality. That this Court decided not to provide such a reminder two years ago does not dispose of the issue; it has often rejected both long and newly established interpretations of law. *See, e.g., West Virginia Board of Education* v. *Barnette*, 319 U.S. 624 (1943); *Erie* v. *Tompkins*, 304 U.S. 64 (1938). To say, as appellees do, that this Court should preclude itself from reviewing a vitally important question affecting one of the Country's essential industries fails to recognize the developments of the past two years and unduly limits the Court's role.

Conclusion

For the foregoing reasons and the reasons in their Jurisdictional Statement, the Companies respectfully submit that the Constitutional question presented by this appeal is of substantial public importance and that appellees' motions to dismiss or affirm should be denied.

Respectfully submitted,

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